



GOVERNOR
JUDY MARTZ

STATE OF MONTANA

Governor's Budget
Fiscal Years 2006 – 2007

Revenue Estimates
General Fund and Select Funds

Governor's Office of Budget
and Program Planning

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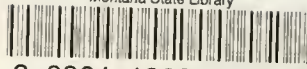
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Revenue Estimates

2007 Biennium



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ECONOMIC OVERVIEW

Introduction

The state budget is affected by state, national, and world economic conditions. The demand for public services is affected by population growth and by how the state's population is faring economically. The cost of providing public services is affected by general inflation and by the costs of specific government purchases, such as utilities. The revenue state government has to pay for public services depends on taxpayers' incomes, property values, and business activity.

The executive budget is based on assumptions about economic conditions through the 2007 biennium. This section describes the key economic assumptions that are common to all of the revenue estimates. It also provides some background by describing long-term trends in the state economy. The sections describing individual revenue estimates explain how each revenue source is related to economic conditions and explain any assumptions that are unique to specific revenue sources.

National Economic Growth

The national economy went through a mild recession in 2000 and 2001. The economy began to recover in 2002, with accelerating growth of gross domestic product (GDP). GDP growth for 2004 is expected to be 4.4%. GDP is expected to grow slower, between 2.9% and 3.5% in 2005 through 2007. National employment fell through the third quarter of 2003, after the economy had resumed growing, and continues to grow slowly. National employment is predicted to grow by 1% in 2004. Employment growth is predicted to accelerate to 1.7% in 2005 and then to slow to about 1% in 2006 and 2007. Inflation has remained low. It is expected to be 2% for 2004 and to be below 2% in 2005 through 2007.

Montana Production and Income

Table 1, on the next page, shows gross state product (GSP), which measures production in the state, and personal income, which measures income state residents receive from all sources, from 1996 through 2003 and Global Insight's forecasts through 2007.

In 2000 and 2001, GSP continued to grow rapidly as the national economy went into a recession. GSP grew more slowly in 2002, but accelerated in 2003 and 2004. In 2004, GSP is expected to grow by almost 6%, faster than in any recent year. GSP growth is expected to slow in 2005 and 2006, but to stay at or above 4.5%.

Personal income in Montana grew rapidly in 2000 and 2001. This growth was due to a combination of increasing economic activity in the state, as reflected in GSP growth, and gains from the stock market boom. Personal income grew by only 1.1% in 2002, but rebounded in 2003.

Personal income growth is expected to be almost 6% in both 2004 and 2005. It is expected to slow in 2006, but to be close to 5% through 2007.

Table 1
Gross State Product and Personal Income
1996 through 2007
(\$ million)

Year	Gross State Product	% Change	Personal Income	% Change
1996	18,073	3.04%	16,880	4.95%
1997	18,906	4.61%	17,688	4.79%
1998	19,972	5.64%	18,857	6.60%
1999	20,567	2.98%	19,373	2.74%
2000	21,703	5.52%	20,716	6.94%
2001	22,635	4.29%	22,281	7.55%
2002	23,518	3.90%	22,526	1.10%
2003	24,583	4.53%	23,652	5.00%
2004	26,052	5.98%	25,056	5.94%
2005	27,396	5.16%	26,552	5.97%
2006	28,625	4.49%	27,813	4.75%
2007	29,948	4.62%	29,147	4.80%

Montana Employment and Population

Table 2 shows Montana employment and population in 1996 through 2003 and Global Insight's forecasts through 2007.

The recession hit Montana's labor market hard. Employment fell by more than 2% in 2001 and was stagnant in 2002. In 2003, employment rebounded slightly above the pre-recession peak in 2000. In 2004, employment is forecast to grow by 1.7%. Employment growth is forecast to peak at almost 2% in 2005 and then to slow.

In the second half of the 1990s, Montana's population grew at about half a percent a year. Growth appears to have slowed slightly in 2001, as some discouraged workers left the state to look for work, but growth accelerated in

Table 2
Montana Employment and Population
1996 through 2007

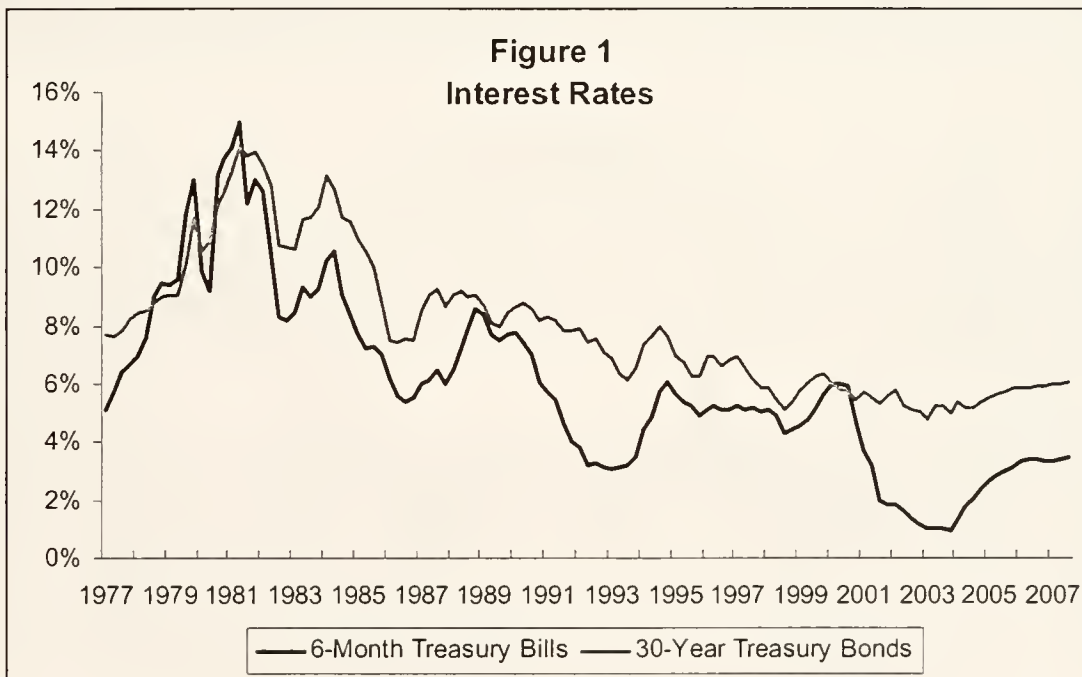
Year	Employment	% Change	Population	% Change
1996	420,694	2.79%	886,321	1.02%
1997	428,580	1.87%	890,120	0.43%
1998	438,029	2.20%	893,221	0.35%
1999	446,689	1.98%	898,288	0.57%
2000	452,149	1.22%	903,494	0.58%
2001	442,015	-2.24%	906,620	0.35%
2002	442,153	0.03%	911,451	0.53%
2003	452,417	2.32%	917,911	0.71%
2004	460,026	1.68%	922,086	0.45%
2005	469,087	1.97%	926,006	0.43%
2006	476,909	1.67%	929,752	0.40%
2007	481,255	0.91%	933,417	0.39%

2002 and 2003. Population growth in 2004 through 2007 is forecast to be about 0.4% per year. This is significantly below national population growth.

Interest Rates

The state earns interest on trust funds, such as the coal severance tax trust fund, the school trust, and the tobacco settlement trust, and on short-term cash holdings in the general fund and other state funds. The state also pays interest on funds it borrows. Trust fund interest earnings and payments on new long-term debt are affected by changes in long-term interest rates. Most bonds held by the state trust funds are kept for several years, and trust fund interest earnings are affected more by long-term trends in interest rates than by year-to-year variations. Interest earnings on cash balances and interest payments on short-term debt are affected by changes in short term interest rates. Earnings on cash balances are affected by year-to-year variations in short-term interest rates as well as by long-term trends.

Figure 1 shows interest rates on 6-month and 30-year U.S. Treasury obligations from 1977 through the second quarter of 2004 and Global Insight's forecasts through 2007.



Interest rates hit historic highs in 1981, with both short-term and long-term interest rates over 14%. Interest rates vary over the course of business cycles, but had a general downward trend from 1981 through 2003. Short-term interest rates show more variation than long-term rates. They fall when the Federal Reserve tries to stimulate the economy by cutting the rate it charges banks. They rise when the

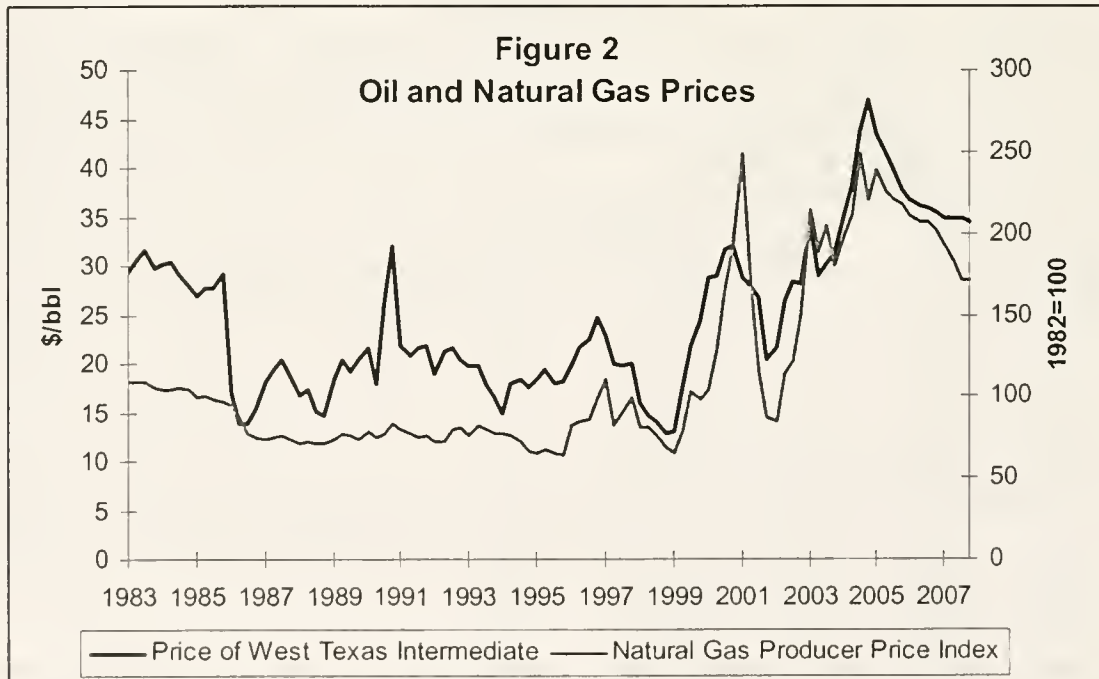
Federal Reserve tries to control inflation by raising the rate it charges banks. Short-term interest rates hit all-time lows early in 2004.

Interest rates began rising in the second quarter of 2004 and are forecast to continue rising through 2007. By the end of 2007, the rate on 6-month Treasury bills is forecast to be 3.5%, and the rate on 30-year treasury bonds is forecast to be 6%.

Oil and Natural Gas Prices

Oil and natural gas prices affect the state budget several ways. The state taxes oil and natural gas production and receives royalties from production on state lands and a share of the royalties from production on federal land in the state. State government buys gasoline and diesel fuel for state vehicles and natural gas for state buildings. Energy prices also affect the state economy, with higher prices translating into higher incomes for the energy producing sector and higher costs for the rest of the economy.

Figure 2 shows national oil and natural gas prices from 1983 through 2004 and Global Insight's forecasts through 2007. It shows the price of the standard grade of crude oil, West Texas Intermediate, measured on the left hand axis. It shows a price index for natural gas, with the average price in 1982 scaled to 100, on the right hand axis.



Oil prices have always been quite volatile. Natural gas prices were less volatile through about 1995, but since then have been at least as volatile as oil prices.

Energy use is relatively insensitive to prices in the short run. Because of this, short run changes in supplies can produce large price swings. In the longer term, energy users respond to higher prices by conserving and using energy more efficiently. Oil and gas producers respond to sustained higher prices by increasing exploration and development activity that increases supplies.

From about 1987 through 1999, oil and natural gas prices were relatively low because of ample world supplies. Since 1999, oil and natural gas prices have risen significantly. There are several reasons for this. World supplies have been stagnant, as oil and gas fields that were developed in the 1970s when prices were high are beginning to be depleted and low prices have limited exploration. World demand has grown steadily, and that growth has accelerated in the last few years as incomes in some developing countries, particularly China, have reached the point where consumers can afford cars, appliances, and other energy using consumer goods. Short-term supply disruptions or scares due to war, political instability in some producing countries, and hurricane damage in the Gulf of Mexico have led to short-term price spikes.

Both oil and natural gas prices are forecast to peak late in 2004 and then to drop through 2007 as short-term supply problems are solved. However, both are expected to remain well above their pre-2000 levels as growing world demand continues to stretch production capacity.

Property Values

Property tax is the largest revenue source in Montana. State and local governments, school districts and special improvement districts collect over \$900 million in property taxes and related fees each year. Property taxes depend on mill levies; property tax rates, which are the ratio of taxable value to market value; and property values.

In the ten-year period from tax year 1993 (FY 1994) to tax year 2002 (FY 2003), the statewide average mill levy increased 38.8%. Mill levies vary dramatically between different cities and different counties. In 2002, city mill levies ranged from 203.23 mills in Colstrip to 1,009.58 mills in Westby. County mill levies ranged from 211.52 mills in Rosebud County to 660.10 mills in Deer Lodge County. These variances result in the individual properties having considerable differences in their property tax bill for comparably valued property.

Recent legislation has reduced tax rates for most classes of property. As property tax rates decline, or property is exempted, the amount of property tax that must be raised from the remaining property tax owners increases. Table 3 shows statewide taxable values for 1998 and 2004, the percent of total taxable value in each property class, and the percent change in taxable value for each class.

Table 3 Property Taxable Values Tax Year 1998 and 2004 Change in Share of Property Tax Base							
Tax Class	Description	Tax Year 1998			Tax Year 2004		
		Tax Rate	Taxable Value	Share of Base	Tax Rate	Taxable Value	% Change Taxable Value
1	Mine Net Proceeds	100.000%	7,625,083	0.4%	100.000%	8,032,414	5.3%
2	Gross Proceeds Metal Mines	3.000%	8,780,907	0.5%	3.000%	10,428,300	18.8%
3	Agricultural Land	3.816%	143,007,340	7.4%	3.300%	139,901,823	-2.2%
4 Res	Residential Real Property	3.816%	704,132,657	36.3%	3.300%	792,062,821	12.5%
4 Com	Commercial Real Property	3.816%	247,920,400	12.8%	3.300%	284,921,721	14.9%
Sub 4	Subtotal Class 4	3.816%	952,053,057	49.0%	3.300%	1,076,984,542	13.1%
5	Pollution Control Equipment	3.000%	34,074,765	1.8%	3.000%	34,024,275	-0.1%
6	Livestock	4.000%	23,833,179	1.2%	0.000%	-	-100.0%
7	Non-Centrally Assessed Utilities	8.000%	1,783,935	0.1%	8.000%	974,316	-45.4%
8	Business Personal Property	6.000%	203,383,266	10.5%	3.000%	117,240,984	-42.4%
10	Forest Land	0.790%	7,677,880	0.4%	0.350%	6,791,382	-11.5%
12	Railroad and Airline Property	6.170%	65,266,087	3.4%	3.810%	45,074,061	-30.9%
9 & 13	Telecom. & Electric Property	12.000%	494,534,742	25.5%	12% & 6%	340,477,889	-31.2%
Totals			1,942,020,241			1,779,929,986	-8.3%

Total taxable value decreased 8.3% from tax year 1998 to tax year 2004. This is primarily attributable to legislation that reduced the tax rates on specific property classes and exempted some types of property from taxation. Total statewide taxable value is expected to increase in 2005 and 2006. All the expected increase is due to new property in class 4, residential and commercial real property, and class 8, business equipment. The total taxable value of all other property classes combined is projected to decline.

The class 4 share of the tax base increased from 49% in 1998 to over 60% in 2004. The percent share of the tax base in class 4 is expected to continue to increase in the future. Under the current property tax structure, class 4 pays the majority of any property tax increases.

Class 8 taxable value declined from 1998 to 2004 because the tax rate was reduced from 6% to 3%. The value of class 8 property is projected to increase through 2007. However, 15-6-138, MCA, provides for a conditional phase-out of tax, referred to as the class 8 trigger, on class 8 property. When inflation-adjusted Montana wage and salary income shows an increase of at least 2.85%, the phase-out of the class 8 property tax is triggered. Beginning three years after the trigger is hit, the tax rate for class 8 property is reduced by 1% each year until it reaches zero. The next trigger test will be based on 2004 data in October of 2005. If the trigger is met, the reduction will begin January 1, 2007. The tax rate for class 8 property would be reduced by 1% each year until it reaches zero.

Structural Trends

Montana's population and economy have undergone significant structural changes. The population has become older, the mix of industries has changed, and the mix of occupations has changed.

Population

Table 4 shows the 1980, 1990, and 2000 census counts of Montana population grouped into ten-year age groups and the percent of the total population in each group. For 1990 and 2000, it also shows the ten-year survival percentage for the groups aged 10 and up. This is the ratio of the number of people in an age group to the number in the next lower age group ten years earlier. For the 80 and over age group, it is the ratio of people 80 or over to the number of people 70 or over ten years earlier. For the total population, it is the ratio of total population to the total ten years earlier.

Table 4 Age Structure of Montana Population								
Age	1980 Census		1990 Census			2000 Census		
	Persons	%	Persons	%	10 yr survival	Persons	%	10 yr survival
0-9	125,315	15.9%	125,603	15.7%		115,931	12.8%	
10-19	136,959	17.3%	120,285	15.0%	96.0%	140,275	15.5%	111.7%
20-29	145,395	18.4%	104,491	13.0%	76.3%	110,151	12.2%	91.6%
30-39	111,036	14.0%	134,798	16.8%	92.7%	118,328	13.1%	113.2%
40-49	77,291	9.8%	104,085	13.0%	93.7%	149,050	16.5%	110.6%
50-59	74,029	9.4%	71,729	8.9%	92.8%	110,143	12.2%	105.8%
60-69	64,756	8.2%	66,959	8.3%	90.4%	70,912	7.8%	98.9%
70-79	37,348	4.7%	49,789	6.2%	76.9%	54,699	6.1%	81.7%
80+	18,263	2.3%	24,201	3.0%	43.5%	34,004	3.8%	46.0%
Total	790,391	100.0%	801,939	100.0%	101.5%	903,494	100.0%	112.7%

Aging Population

In 1980, the 20 to 29 age group was the largest. People in this age group were born between 1951 and 1960, the final years of the post-World War II baby boom and the years immediately after. People born between 1951 and 1960 were in the 30 to 39 age group in 1990 and the 40 to 49 age group in 2000, and make up the largest age group in those years too.

In 1990 and 2000, the second largest age group was people born between 1981 and 1990, who were between 0 and 9 in 1990 and between 10 and 19 in 2000. This second peak in the age distribution is caused by the children of the baby boomers and is often called the baby boom echo.

As the baby boomers have aged and life expectancies have increased, the population as a whole has become older. In 1980, 34% of the population was 40 or over and 15% was 60 or over. In 1990, 40% of the population was 40 or over and 18% was 60 or over. By 2000, the percentage 40 or over had increased to 46% and the percentage 60 or over remained at 18%. This aging of the population mirrors the national trend and will continue. In 2010, the 50 to 59 age group will probably be the largest.

Table 5 Aging of Montana Population				
	1980 Census	1990 Census	2000 Census	2010 Forecast
Age 40 and Over	34.4%	39.5%	46.4%	49.6%
Age 60 and Over	15.2%	17.6%	17.7%	21.8%

Population Migration

The ten-year survival percentages, shown in Table 4, give information on population growth and movements into and out of the state. The numbers in the totals row show the change in total population from one census to the next. Montana had very little population growth from 1980 to 1990. Montana's population in 1990 was only 101.5% of the 1980 population. In 2000, Montana's population was 112.7% of what it had been in 1990. This 12.7% population growth is just slightly less than national population growth of 13.2%.

In a population with no one moving in or out, ten-year survival percentages reflect mortality. They are close to 100% for the younger age groups and fall off rapidly after middle age. The 1990 survival percentages follow this pattern with one significant exception. The 20 to 29 age group's survival percentage is 76%. This shows that at least 20% of the 10 to 19 year olds who lived in Montana in 1980 had moved out of the state by 1990, when they were between 20 and 29 years old. Some people in this age group moved into the state, so the percentage that left must be greater than 20%. For the other age groups, people moving into the state about equaled people moving out of the state.

Population growth from 1990 to 2000 was a combination of natural increase due to more births than deaths and net in-migration, with more people moving to the state than moving away. Survival percentages are more than 100% for four age groups, 10 to 19, 30 to 39, 40 to 49, and 50 to 59, and is 99% for the 60 to 69 age group. This shows that more people in these age groups moved to the state than moved away. In the 1990s people over 30 moved to the state and brought their children. In

2000, the survival percentage for the 20 to 29 age group is only 92%, indicating that more people in this age group moved away than moved in.

Economic Structure

Table 6 shows the Montana economy divided into eleven sectors, with gross state product for each sector and the percentage of gross state product produced by each in 1992, 1997, and 2002, and Global Insight's forecast for 2007. The sectors are sorted in descending order of the value by output in 1992. For sectors that have grown faster than the economy as a whole, the percent of total output has increased over time. For sectors that have not grown as fast as the economy, the percent has decreased. The service sectors are growing the fastest.

Table 6 Montana Gross State Product								
Economic Sector	1992		1997		2002		2007	
	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total
Services	2,693	17.9%	3,745	19.8%	5,063	21.5%	6,978	23.3%
Finance, Insurance, & Real Estate	1,975	13.1%	2,570	13.6%	3,354	14.3%	4,515	15.1%
Transp., Comm., & Util.	1,855	12.3%	2,229	11.8%	2,547	10.8%	3,004	10.0%
State and Local Gov't, Schools	1,619	10.7%	2,029	10.7%	2,784	11.8%	3,541	11.8%
Retail Trade	1,517	10.1%	1,932	10.2%	2,418	10.3%	3,058	10.2%
Manufacturing	1,180	7.8%	1,438	7.6%	1,562	6.6%	1,880	6.3%
Agriculture, Forestry, & Fishing	957	6.3%	871	4.6%	865	3.7%	754	2.5%
Federal Government	949	6.3%	1,101	5.8%	1,242	5.3%	1,465	4.9%
Wholesale Trade	914	6.1%	1,268	6.7%	1,427	6.1%	1,847	6.2%
Mining	809	5.4%	734	3.9%	857	3.6%	923	3.1%
Construction	617	4.1%	989	5.2%	1,399	6.0%	1,984	6.6%

- Services and finance, insurance, and real estate are the two largest sectors, together accounting for 36% of the value of output in 2002. Both sectors have grown faster than the economy as a whole since 1992 and are forecast to continue to do so. They are forecast to account for 38% of output in 2007.
- Two other sectors also increased over time as a percent of the total. They are the construction sector and state and local government and schools.
- Retail trade and wholesale trade have consistently grown at about the same rate as the economy as a whole. Together they accounted for a little over 16% of output in each of the four years.
- Transportation, communications and utilities, manufacturing, and mining have grown more slowly than the economy as a whole. Together they accounted for 25% of output in 1992, but they are forecast to account for only 19% in 2007.

- Agriculture, forestry, and fishing is the only sector where the value of output has consistently decreased over time.

Like the national economy, the Montana economy is primarily a service-producing economy rather than a goods-producing economy, and this has become truer over time. Four sectors produce services almost exclusively. They are services; finance, insurance, and real estate; retail trade; and wholesale trade. Four sectors produce physical goods almost exclusively. They are manufacturing; agriculture, forestry and fishing; mining; and construction. The other three sectors produce a mix of goods and services. Together, the service-producing sectors accounted for 47% of output in 1992, and they are predicted to account for 55% in 2007. The mixed sectors accounted for 29% of output in 1992 and are predicted to account for 27% of output in 2007. The goods-producing sectors accounted for 24% of output in 1992. This is predicted to fall to 19% in 2007.

Table 7¹ shows the Montana economy divided into fifteen sectors² in 1992, 1997, and 2002, and Global Insight's forecasts for 2007.

Table 7 Montana Wage and Salary Income								
Economic Sector	1992		1997		2002		2007	
	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total	\$ Million	% of Total
State & Local Govern't, Schools	1,167	17.9%	1,450	17.1%	1,813	16.6%	2,249	16.2%
Educational & Health Svcs	775	11.9%	1,064	12.5%	1,469	13.5%	1,933	13.9%
Retail Trade	672	10.3%	856	10.1%	1,073	9.8%	1,291	9.3%
Construction and Mining	552	8.5%	754	8.9%	960	8.8%	1,345	9.7%
Manufacturing	515	7.9%	643	7.6%	678	6.2%	787	5.7%
Transportation, Warehousing, & Utilities	443	6.8%	529	6.2%	605	5.5%	719	5.2%
Federal Government	417	6.4%	470	5.5%	592	5.4%	705	5.1%
Wholesale Trade	354	5.4%	441	5.2%	523	4.8%	642	4.6%
Professional & Business Svcs	346	5.3%	584	6.9%	915	8.4%	1,276	9.2%
Leisure & Hospitality	335	5.1%	481	5.7%	612	5.6%	799	5.8%
Financial Activities	318	4.9%	438	5.2%	630	5.8%	884	6.4%
Other Services	192	3.0%	266	3.1%	361	3.3%	445	3.2%
Military	154	2.4%	150	1.8%	197	1.8%	232	1.7%
Information	153	2.4%	191	2.3%	256	2.3%	320	2.3%
Agriculture, Forestry, & Fishing	114	1.8%	170	2.0%	223	2.0%	275	2.0%

There are five sectors where total wage and salary payments have consistently grown faster than in the economy as a whole. They are educational and health services, construction and mining, professional and business services, leisure and hospitality, and financial activities. In three sectors, wage and salary payments have grown about as fast as in the economy as a whole. They are other services,

¹ Tables 7 divides the economy into the sectors used in the new North American Industry Classification System while Table 6 uses the sectors from the old Standard Industrial Classification system because historic GSP data have not been converted to the new system yet.

² The growth in total wages and salaries for a sector is due to a combination of growth of employment in that sector and growth of average wages. These differ between sectors.

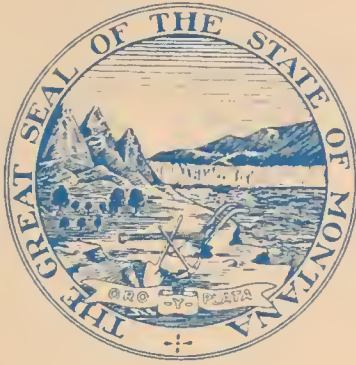
information, and agriculture, fisheries and forestry. In the other seven sectors total wage and salary payments have grown, but not as fast as in the economy as a whole.

Economic Overview Summary

Montana income growth is expected to be about 5% with employment growing steadily and population increasing slightly. The Montana population is aging with the 20-29 year age group leaving the state and older people moving into the state.

Interest rates and oil and natural gas prices will rise and be maintained for a while, enhancing the state's revenue. Property taxes are increasing significantly due more to mill levy increases than to valuation increases.

The economy has turned from a goods-based economy into a service economy. The tax structure will need to be monitored to determine the impact of the shift to a service based economy and the aging population.



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STATE OF MONTANA

GENERAL FUND REVENUE ESTIMATES

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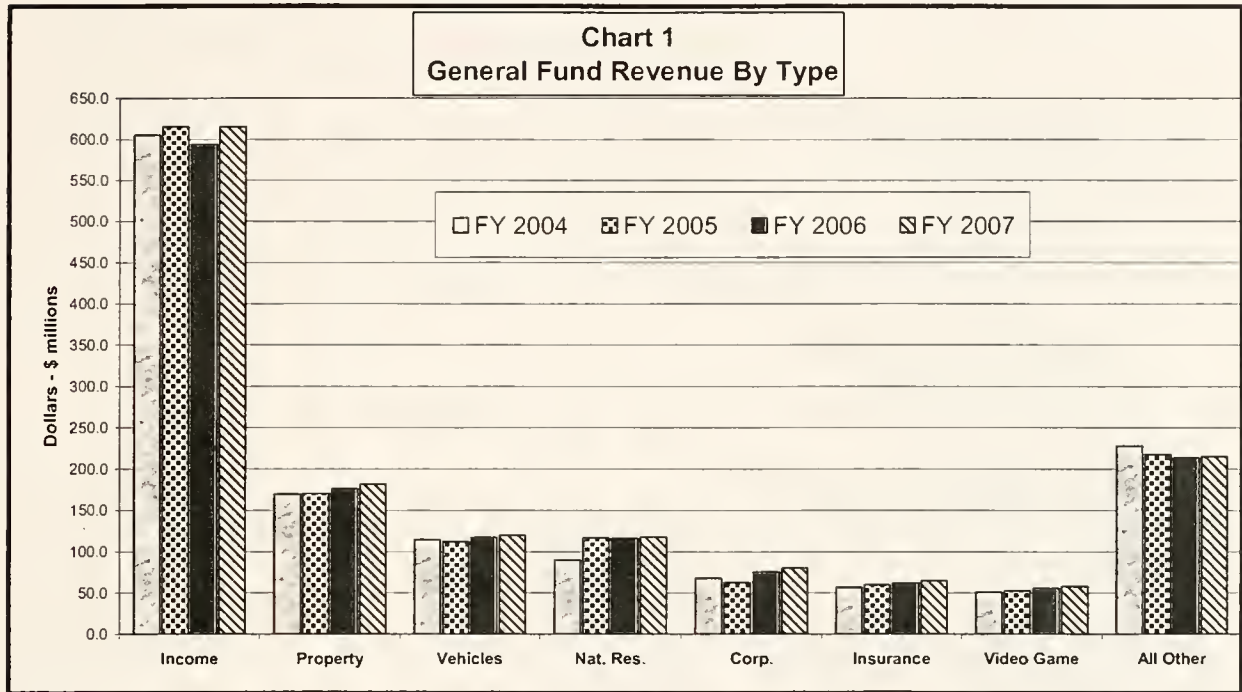
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GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

General Fund Revenue Estimate Summary

The state general fund accounts for all financial resources except those required by law to be accounted for in another fund. Chart 1 summarizes the general fund revenue in eight groups. Seven major revenue sources comprise 85% of the general fund revenue. Each of these revenue sources¹ is over \$50 million.



Individual income tax is the predominant revenue source. Individual income tax at \$615 million is 42% of the general fund revenue for FY 2007. Property tax and the related non-levy revenue is \$182 million, representing 13% of the general fund revenue for FY 2007. Every other revenue category comprises less than 10% of the general fund revenue in FY 2007.

Table 1, on the following page, shows the 34 general fund revenue categories. The six major taxes, which bring in more than \$50 million a year for each tax, comprise 77% of the general fund revenue in FY 2007. As a group, natural resource taxes contribute approximately 8% of the general fund in FY 2007. Every other revenue category is less than 4% of the total general fund revenue in FY 2007.

¹ Vehicle revenue is both vehicle taxes and registration fees. The natural resource category is comprised of oil and natural gas production taxes, U.S. mineral royalties, coal severance tax, metal mines tax, electrical energy tax, and wholesale energy transaction tax.

Table 1
General Fund Revenue - FY 2004 through FY 2007
(\$ millions)

Revenue Category	Actual FY 2004	----- Forecast ----- FY 2005 FY 2006 FY 2007			% of Total General Fund
MAJOR TAXES					
Individual Income Tax	605.348	615.267	593.502	615.247	42.36%
Property Tax	169.531	170.077	175.807	181.990	12.53%
Vehicle Taxes and Fees	114.331	112.089	116.909	119.874	8.25%
Corporation license Tax	67.723	62.448	75.666	80.269	5.53%
Insurance Premiums Tax	56.527	59.692	62.095	64.539	4.44%
Video Gambling License Tax	50.749	52.970	55.449	57.785	3.98%
Total Major Taxes	1,064.209	1,072.544	1,079.429	1,119.704	77.08%
NATURAL RESOURCE TAXES					
Oil and Gas Production Taxes	41.324	58.296	58.505	59.182	4.07%
U.S. Mineral Royalties	28.736	36.351	35.322	36.219	2.49%
Coal Severance Tax	8.643	9.255	8.638	8.567	0.59%
Metalliferous Mines Tax	3.232	5.257	5.696	5.975	0.41%
Electrical Energy Tax	4.661	4.243	4.243	4.243	0.29%
Wholesale Energy Transactions Tax	3.293	3.485	3.520	3.555	0.24%
Total Natural Resource Taxes	89.888	116.887	115.924	117.742	8.11%
INTEREST EARNINGS					
Coal Trust Interest Earnings	34.907	34.003	34.293	34.484	2.37%
Treasury Cash Account Interest	6.393	9.885	12.821	13.498	0.93%
Total Interest Earnings	41.300	43.888	47.113	47.982	3.30%
LIQUOR TAXES					
Liquor Excise and License Taxes	10.718	11.109	11.476	11.856	0.82%
Liquor Profits	6.500	6.669	6.889	7.117	0.49%
Beer Tax	2.897	2.860	2.913	2.965	0.20%
Wine Tax	1.423	1.491	1.561	1.634	0.11%
Total Liquor Taxes	21.538	22.129	22.840	23.572	1.62%
TOBACCO TAXES					
Cigarette Tax	36.002	34.467	33.199	32.346	2.23%
Tobacco Products Tax	3.562	3.574	3.589	3.622	0.25%
Tobacco Settlement Funds	2.934	2.908	2.368	2.339	0.16%
Total Tobacco Taxes	42.497	40.949	39.156	38.307	2.64%
SALES TAXES					
Telecommunications Excise Tax	20.919	21.314	21.717	22.127	1.52%
Institutional Reimbursements	18.110	16.314	15.123	15.134	1.04%
Sales Tax- Accommodations	9.279	10.113	10.715	11.419	0.79%
Health Care Facilities Fees	5.916	5.763	5.665	5.555	0.38%
Sales Tax - Rental Cars	2.486	2.563	2.643	2.724	0.19%
Total Sales Taxes	56.710	56.068	55.863	56.959	3.92%
OTHER TAXES AND REVENUES					
Lottery	8.116	7.002	7.009	7.899	0.54%
Highway Patrol Fines	4.084	4.287	4.370	4.453	0.31%
Investment License and Permits	4.834	4.123	3.923	3.733	0.26%
Contractors' Gross Receipts Tax	2.120	1.956	2.605	2.400	0.17%
Driver's License Fee	3.021	2.825	3.031	2.886	0.20%
Rail Car Tax	1.568	1.585	1.621	1.656	0.11%
Estate Tax	11.431	5.171	2.301	1.651	0.11%
Other Revenue	29.432	27.792	23.589	23.634	1.63%
State Fund Reserve Transfer	0.816	0.000	0.000	0.000	0.00%
Total Other Taxes and Revenues	65.422	54.741	48.449	48.310	3.33%
TOTAL GENERAL FUND REVENUE	1,381.565	1,407.205	1,408.774	1,452.577	100.00%

INDIVIDUAL INCOME TAX

Revenue Description

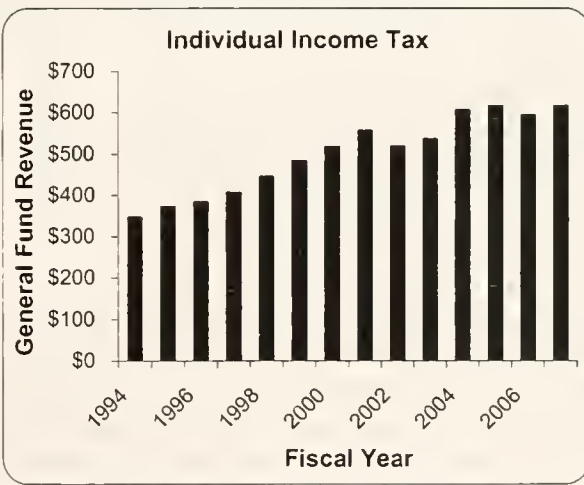
Title 15, chapter 30, MCA, imposes a graduated individual income tax on gross income less exemptions and deductions. A taxpayer's Montana adjusted gross income is based on their federal adjusted gross income but may be higher or lower because some types of income are taxed by one level of government but not the other. Itemized deductions for federal and state income tax also are similar, except that state income tax may be deducted in calculating federal taxable income while federal income tax may be deducted in calculating state taxable income. Through tax year 2004, marginal tax rates range from 2% to 11%. Beginning with tax year 2005 marginal rates will range from 1% to 6.9%. Montana also allows a number of credits that may reduce taxpayers' liabilities. Between \$1 million and \$3 million of income tax revenue is allocated to pay for the Department of Revenue's new data processing system. The remainder is allocated 100% to the general fund.

Historical and Projected Revenue

Individual income tax is the single largest source of revenue to the general fund. In FY 2004, individual income tax collections were 43.8% of total general fund revenue. Table 1 shows individual income tax collections for FY 1994 through FY 2004 and projected collections for FY 2005 through FY 2007.

Table 1
Individual Income Tax Collections
(\$ millions)

Fiscal Year	Collections	General Fund	Percent Change
A 1994	\$345.643	\$345.643	-3.18%
A 1995	\$371.903	\$371.903	7.60%
A 1996	\$383.092	\$383.092	3.01%
A 1997	\$406.276	\$406.276	6.05%
A 1998	\$444.191	\$444.191	9.33%
A 1999	\$483.032	\$483.032	8.74%
A 2000	\$516.262	\$516.262	6.88%
A 2001	\$556.015	\$556.015	7.70%
A 2002	\$517.568	\$517.568	-6.91%
A 2003	\$535.831	\$535.831	3.53%
A 2004	\$605.582	\$605.348	12.97%
F 2005	\$616.543	\$615.267	1.64%
F 2006	\$596.276	\$593.502	-3.54%
F 2007	\$618.430	\$615.247	3.66%



Income tax revenue grew fairly steadily from FY 1994 to FY 2001. Revenue grew faster than normal in the second half of the 1990s as the national economy went through a prolonged expansion and the optimism that fueled a rapidly rising stock market led to large increases in capital gains income. Revenue dropped by almost 7% in FY 2002 as the national economy went through a recession and the stock market bubble burst. Revenue grew 3.5% in FY 2003 as the national economy recovered slowly and taxpayers realized the paper losses they had incurred in the stock market. In FY 2004, revenue grew by 13%. Income is projected to continue to grow strongly through FY 2006, but revenue is projected to grow by only 1.6% in FY 2005 and to decrease by 3.6% in FY 2006 as the rate reductions in SB 407 (2003 session) go into effect January 1, 2005. Income growth is projected to slow in FY 2007, but revenue is projected to grow by 3.7%.

Forecast Summary

Income tax collections through FY 2007 are affected by the projected growth of income and changes to tax rates, deductions, and credits enacted in SB 407 (2003 session).

Income Growth

Table 2 shows income reported on tax returns for calendar year (CY) 2003 and CY 2004 and projections for CY 2005 through CY 2007. The table also shows income divided into five categories and the total and annual percentage growth rates.

Table 2 Forecast Income Growth										
Income Source	CY 2003		CY 2004		CY 2005		CY 2006		CY 2007	
	\$ billion	% Chg	\$ billion	% Chg	\$ billion	% Chg	\$ billion	% Chg	\$ billion	% Chg
Labor	9.650	4.1%	10.285	6.6%	10.795	5.0%	11.157	3.4%	11.541	3.4%
Ownership	1.753	0.9%	1.862	6.3%	2.008	7.8%	2.094	4.3%	2.230	6.5%
Retirement	1.575	4.7%	1.636	3.8%	1.726	5.5%	1.805	4.6%	1.887	4.6%
Gains/Losses	0.846	26.3%	0.980	15.8%	0.881	-10.2%	0.833	-5.4%	0.838	0.5%
Interest	0.453	-14.4%	0.383	-15.6%	0.417	8.9%	0.526	26.4%	0.539	2.4%
Total	14.277	4.2%	15.146	6.1%	15.826	4.49%	16.415	3.72%	17.034	3.77%

The labor category consists of income reported on tax returns as wages and salaries. The ownership category consists of dividends; net business income; rents, royalties, and partnership income; net farm income; and income reported as other income. The retirement category consists of the taxable portion of Social Security, taxable pensions, and taxable IRA distributions.

Table 3 compares the forecast average annual growth rates through CY 2007 with average annual growth rates from CY 1987 through CY 2003.

Since CY 1987, labor income has grown at an average rate of 5.2%. The forecast is for labor income to grow faster than 5.2% in CY 2004 and then slow in CY 2005 through CY 2007. The average growth rate of labor income is projected to be 0.6% lower in CY 2004 through CY 2007 than in CY 1987 through CY 2003.

Table 3 Income Growth - Forecast and History		
Income Source	-----Average Annual Growth Rates-----	
	CY 1987-CY 2003	CY 2004-CY 2007
Labor	5.2%	4.6%
Ownership	8.8%	6.2%
Retirement	9.4%	4.6%
Gains/Losses	5.9%	-0.3%
Interest	-1.4%	4.4%
Total	5.5%	4.5%

Ownership income grew at an average rate of 8.8% from CY 1987 through CY 2003. The forecast is for ownership income to grow slower in CY 2004 through CY 2007. The average forecast growth rate is 6.2%.

Retirement income grew at an average rate of 9.4% from CY 1987 through CY 2003. The forecast is for retirement to grow at an average rate of 4.6%. Retirement income is projected to grow faster in CY 2005 than in the other years because of expected movements in the stock market and growth of the national economy.

Gains and losses on the sale of assets grew at an average annual rate of 5.9% from CY 1987 through CY 2003. However, gains and losses have been quite volatile in the recent past. They grew at an average rate of 18.5% from CY 1995 through CY 2000 and then fell at an average rate of 28.4% from CY 2000 through CY 2002. Gains and losses increased by 26.3% in CY 2003. They are forecast to increase by 15.8% in CY 2004, which will put them at 75% of their peak level in CY 2000, but then to decrease in CY 2005 and CY 2006.

Interest income varies significantly with interest rates. It fell in CY 2002 and CY 2003 as interest rates dropped to historic lows. Interest income is forecast to fall again in CY 2004 and then to begin rising in CY 2005 following increases in interest rates beginning in CY 2004.

Total income grew at an average annual rate of 5.5% from CY 1987 to CY 2003. During the same period, income tax collections grew at an average annual rate of 6.7%. With income growing faster than inflation, rate brackets and deductions indexed for inflation, and no changes to rates, income tax collections generally can be expected to grow slightly faster than income. With significant rate changes beginning in CY 2005, collections will grow slower than income for the next several years.

SB 407 – New Rate Table

SB 407 (2003 session) reduced income tax rates, provided for a credit for part of capital gains income, and limited the itemized deduction for federal income taxes. Table 4 shows the rate tables in effect for CY 2004, the last year before the income tax provisions of SB 407 go into effect, and for CY 2005, the first year SB 407 is in effect. The new rate table has fewer rates and lower minimum and maximum rates.

Table 4			
Income Tax Rate Tables Before and After SB 407			
Projected 2004 Rate Table (before SB407)		2005 Rate Table (after SB407)	
Taxable Income	Tax	Taxable Income	Tax
\$2,300 or less	2% of taxable income	\$2,300 or less	1% of taxable income
\$2,301 to \$4,600	3% minus \$23	\$2,301 to \$4,100	2% minus \$23
\$4,601 to \$9,100	4% minus \$69	\$4,101 to \$6,200	3% minus \$64
\$9,101 to \$13,700	5% minus \$160	\$6,201 to \$8,400	4% minus \$126
\$13,701 to \$18,200	6% minus \$297	\$8,401 to \$10,800	5% minus \$210
\$18,201 to \$22,800	7% minus \$479	\$10,301 to \$13,900	6% minus \$318
\$22,801 to \$31,900	8% minus \$707	over \$13,901	6.9% minus \$443
\$31,901 to \$45,500	9% minus \$1,026		
\$45,501 to \$79,700	10% minus \$1,481		
over \$79,700	11% minus \$2,278		

The two rate tables were used to calculate tax liability for taxable incomes ranging from \$0 to \$1 million. In CY 2005, taxpayers with taxable income less than \$16,300 or more than \$24,100 will have lower income tax liability. Taxpayers with taxable income between \$16,300 and \$24,100 will have their tax liability increased, but by less than \$20. The change in rates will reduce total tax liability.

SB 407 – Limit on Deduction for Federal Income Tax

SB 407 limits the itemized deduction for federal taxes to \$10,000 for married couples filing jointly and \$5,000 for other filers. This has no effect on taxpayers who take the standard deduction or taxpayers who itemize but pay less than \$5,000 in federal income tax (\$10,000 if filing jointly). For taxpayers who pay more federal income tax, the limited deduction for federal income tax increases their taxable income and, therefore, their tax.

Taxpayers who claim an itemized deduction for federal taxes paid during a year reduce their state income tax liability. If it turns out that they over paid federal taxes that year and receive a refund the next year, that refund must be reported as income for state income tax. This results in the taxpayer's state taxable income being reduced by the net amount paid to the federal government each year, i.e., taxes paid

less refunds. This is referred to as the tax benefit rule – a federal income tax refund must be counted as income if the taxpayer received the benefit of deducting it the previous year.

Beginning in CY 2005, any federal income tax paid over the \$5,000 cap (\$10,000 for joint filers) does not reduce state income tax so there is no state tax benefit from federal taxes paid over the cap. If the taxpayer receives a refund the next year, it will be counted as income only to the extent that it reduces the net amount paid (federal tax paid minus the refund) below the cap. For example, a married taxpayer filing jointly who paid \$11,000 in federal tax in CY 2005 and received a refund of \$100 in CY 2006 would not have to report it as income. A married taxpayer filing jointly who paid \$11,000 in federal tax and received a refund of \$1,100 would have to report \$100 as income.

The tax benefit rule reduces taxable income and tax liability for some taxpayers with federal income tax over the cap, partially offsetting the additional tax paid because of the cap.

The net effect of the cap on federal deductibility is to increase tax liability of higher income taxpayers, but by less than the new rate table reduces it.

Recent federal legislation has raised the income level at which alternative minimum tax applies, but only through CY 2005. Under current law, the number of taxpayers paying federal alternative minimum tax will increase significantly in CY 2006, and these taxpayers will pay more federal income tax. Without SB 407, this would reduce their state income tax liability. However, many of these taxpayers are near or over the cap on federal deductibility, and the increase in federal income tax payments will have a very small effect on state tax liability.

Congress is very likely to permanently increase the alternative minimum tax threshold before CY 2006. Because of the cap on federal deductibility, this change will have a minimal effect on state income tax collections.

SB 407 – Capital Gains Credit

In CY 2005 and CY 2006, taxpayers will be allowed to claim a tax credit equal to 1% of their capital gains income. Beginning in CY 2007, the credit will be 2% of capital gains income. This is equivalent to taxing capital gains at a lower rate than other income. This reduces total tax liability.

Forecast – Effects of Income Growth and SB 407

Table 5 shows how forecast income growth and SB 407 affect income tax collections. The second and third columns show collections and their annual

percent growth with forecast income growth and the pre-SB 407 tax law. The fourth and fifth columns shows collections and their annual percent growth with forecast income growth and SB 407. The two right hand columns show the effects of SB 407 on collections and their growth rate.

Table 5 Revenue Impacts of Income Growth and SB 407 (\$ millions)						
Fiscal Year	Old Law with Forecast Income Growth		SB 407 with Forecast Income Growth		SB 407 Impact	
	Collections	% Change	Collections	% Change	Collections	Growth Rate
F 2005	630.365	4.09%	608.524	0.49%	-21.841	-3.61%
F 2006	640.122	1.55%	604.295	-0.69%	-35.826	-2.24%
F 2007	652.744	1.97%	618.430	2.34%	-34.314	0.37%

Income is forecast to grow slightly slower than the average rate of the last fifteen years. By itself, this would produce slower growth in income tax collections. In FY 2005 and FY 2006, SB 407 will reduce collections by about as much as income growth would have increased them. The result is very little growth in collections in FY 2005 and reduced collections in FY 2006. Collections are forecast to resume growing in FY 2007, and collections growth from FY 2007 on will be driven by income growth.

Forecast Methodology and Projection Calculation

The process of estimating income tax revenue centers around a computer program that calculates tax liability for individual income tax returns. The program reads all of the information from each full year resident return in the latest year's income tax returns database. For each return, it calculates the current year's tax liability. It then applies an annual growth rate to each of the income and deduction line items on the return and calculates the next year's tax liability. It repeats this process, growing income and deductions and calculating tax liability, for each year of the forecast.

Before the program is run, growth rates for income and deduction line items must be forecast and future tax parameters, such as rate brackets and caps on deductions must be calculated based on forecasts of inflation and any changes in state or federal law.

After the program is run, the growth in calendar year tax liability for full year filers that it produces is used to estimate growth in fiscal year revenue.

The estimation process can be divided into eight steps:

1. Forecast growth rates for individual income and deduction line items and number of taxpayers.
2. Divide income and deduction growth by growth in taxpayers to give per capita growth.
3. Incorporate changes in state and federal law and forecast inflation into the program for calculating future years' tax liability.
4. Use the program to calculate tax liability in CY 2003 through CY 2007 for full year residents who filed a return for CY 2002 assuming that their income and deductions line items grow as forecast. Adjust the future tax liability of CY 2002 full year filers for the percentage of taxes paid by non-residents and part-year residents and for population growth to estimate total liability for each calendar year.
5. Estimate credits that will be claimed each year and subtract this amount from total liability to give the calendar year tax associated with returns.
6. Allocate calendar year tax to fiscal years and calculate annual growth rates of fiscal year tax liability.
7. Apply the fiscal year growth rates to the last full fiscal year's revenue with audit revenue removed to give fiscal year collections without audit revenue.
8. Add projected audit revenue and any other adjustments to give estimates of fiscal year revenue.

Forecast Growth Rates for Income and Deduction Line Items

Taxpayers report income on up to eleven lines on the tax return. In Table 2, these were combined into five categories, but each line is forecast separately. Table 6 shows the eleven income line items and their categories, the amount of income reported for CY 2003 by full year residents, the percentage of total income in that category in CY 2003, and the percentage of income reported in that category over the last ten years.

Table 6 Calendar Year Income Reported by Full Year Residents			
Type of Income	CY 2003 Income (\$ millions)	% of CY 2003 Income	% of CY 1993 - CY 2003 Income
Labor Income			
Wages, salaries, tips, etc.	\$9,649.687	67.59%	65.30%
Ownership Income			
Rents, royalties, partnerships, etc.	\$1,019.724	7.14%	6.48%
Net business income	\$629.701	4.41%	4.91%
Dividend income	\$297.423	2.08%	2.50%
Net farm income	-\$146.211	-1.02%	-0.81%
Other income	-\$47.936	-0.34%	-0.21%
Retirement			
Taxable portion of Soc. Sec.	\$267.287	1.87%	1.64%
Taxable Pensions, IRAs	\$1,307.739	9.16%	8.39%
Gains and Losses			
Capital gain or (loss)	\$790.913	5.54%	6.67%
Supplemental gains or (losses)	\$55.547	0.39%	0.37%
Interest			
Interest income	\$453.025	3.17%	4.76%
TOTAL INCOME	\$14,276.899	100.00%	100.00%

The largest income type is wages, salaries, tips, and other labor income. It accounts for about two-thirds of income.

Ownership income is reported on five tax return lines.

Rents, royalties, and partnership income is income from ownership of tangible or intangible property, from a partnership in a business, or from passive participation in a business. It averages about 6.5% of income.

Net business income is income that individuals receive from their direct ownership of a business. It averages about 5% of income. Dividends are income that individuals receive from owning shares of an incorporated business. Dividends average about 2.5% of income.

Net farm income is the net of income and losses from unincorporated agricultural operations and is negative most years.

Other income is income that does not fit on one of the other lines. Total other income generally is negative but small relative to total income.

Retirement income has grown faster than other types of income and is expected to continue to do so. Retirement income is reported on two lines.

The taxable portion of Social Security averaged 1.6% of income from CY 1993 through CY 2003.

Taxable retirement income from pensions, IRA distributions, and other sources except Social Security averaged 8.4% of income.

Gains and losses from the sale of assets are reported on two lines. Most are reported as capital gains. A small amount of gains or losses on the sale of business assets are reported as supplemental gains. Together, capital gains and supplemental gains averaged a little more than 7% of revenue over the last ten years, but this period includes the unusually high capital gains of the late 1990s.

Interest averages about 5% of reported income, but varies from year to year.

Wages and Salaries

Wage and salary income is estimated in two steps. First, Global Insight's forecasts of Montana employment and average annual wages for 16 sectors of the state economy are used to construct a forecast of total wage and salary income. Second, total wage and salary income is adjusted to estimate wages and salaries reported on full year residents' income tax returns.

Table 7 shows the forecasts of employment growth. The first column lists the 16 sectors of the state economy, in decreasing order of employment. The second column shows the percent of state employment in each sector in CY 2003. The third column shows the average growth rate of employment in each sector from CY 1991 through CY 2003. The next four columns show the forecast growth rates for CY 2004 through CY 2007. The final column shows the average forecast growth rates for CY 2004 through CY 2007.

Table 7 Employment Growth - Calendar Year							
Industry	2003 % of Employ- ment	Growth Rate					Average 2004 - 2007
		Average 1991- 2003	2004	2005	2006	2007	
State & Local Gov't (inc. Schools)	16.00%	1.68%	0.67%	0.96%	0.50%	0.40%	0.63%
Retail Trade	11.94%	1.98%	1.24%	1.09%	1.34%	1.31%	1.24%
Educational and Health Services	11.87%	3.21%	1.36%	2.52%	2.13%	1.39%	1.85%
Leisure and Hospitality	11.62%	2.99%	2.20%	3.09%	2.30%	2.34%	2.48%
Agriculture, Forestry, and Fishing	9.06%	0.82%	0.76%	1.99%	1.26%	1.21%	1.30%
Professional & Business Services	7.30%	5.97%	2.61%	4.47%	3.04%	3.48%	3.40%
Construction	5.14%	5.87%	4.59%	3.47%	1.20%	1.11%	2.58%
Financial Activities	4.51%	2.95%	3.36%	2.04%	0.54%	0.71%	1.66%
Manufacturing	4.21%	-0.12%	1.84%	2.93%	1.02%	0.95%	1.68%
Other Services	3.58%	2.78%	1.22%	-0.07%	0.15%	0.89%	0.55%
Transport, Warehousing, Utilities	3.43%	-0.33%	1.16%	0.75%	0.27%	0.30%	0.62%
Wholesale Trade	3.43%	1.05%	0.46%	1.10%	0.92%	0.61%	0.77%
Federal Government	3.09%	0.42%	1.30%	0.02%	-0.17%	0.07%	0.30%
Military	1.80%	-2.22%	-3.38%	-1.70%	-1.42%	-0.68%	-1.80%
Information	1.69%	1.06%	1.59%	2.26%	-0.19%	1.01%	1.16%
Natural Resources and Mining	1.34%	-1.58%	11.55%	6.81%	1.37%	0.04%	4.84%
Total	100.00%	2.06%	1.66%	2.02%	1.27%	1.24%	1.55%

Overall, employment is forecast to grow at an average rate of 1.55%. This is about half a percentage point lower than the 2.06% average rate of growth in 1991 through 2003. The fastest growing industries are projected to be natural resources and mining, professional and business services, construction, and leisure and hospitality. The only industry projected to lose jobs is the military.

From CY 1991 to CY 2002, Montana's population grew at an average rate of 1.07%. Employment grew faster than the population as the fraction of the population doing paid work increased and the fraction of the population holding more than one job increased. These trends are expected to continue for the near future. Employment growth is forecast to be higher or lower than the average each year in response to differences in national growth.

Table 8 shows the forecasts of growth in average wages. It has the same structure as Table 3 except that industries are sorted by decreasing average wage, which is shown in the second column. Also, Global Insight forecasts construction and mining employment separately but combines them when forecasting average wages.

Table 8 Growth of Average Wages - Calendar Year							
Industry	2003 Average Wage	Growth Rate					Average 2004 - 2007
		Average 1991- 2003	2004	2005	2006	2007	
Federal Government	\$45,670	3.65%	1.99%	2.52%	2.60%	2.74%	2.46%
Transport, Warehousing, Utilities	\$39,545	3.08%	3.38%	4.08%	3.56%	3.56%	3.64%
Construction and Mining	\$35,594	2.09%	3.88%	4.62%	2.92%	3.10%	3.63%
Manufacturing	\$35,329	3.35%	1.29%	2.39%	2.99%	3.21%	2.47%
Wholesale Trade	\$34,901	2.89%	5.50%	3.29%	3.22%	3.26%	3.81%
Financial Activities	\$34,389	4.15%	5.89%	4.16%	3.69%	4.11%	4.46%
Information	\$33,859	3.20%	6.15%	3.87%	3.94%	3.57%	4.38%
Professional & Business Services	\$29,707	4.24%	3.55%	3.60%	3.47%	3.40%	3.50%
Educational and Health Services	\$29,101	3.90%	4.16%	3.64%	3.68%	3.67%	3.78%
Military	\$26,842	5.10%	7.94%	2.08%	2.11%	2.12%	3.53%
State & Local Gov't (inc. Schools)	\$26,628	3.70%	7.07%	1.97%	2.48%	2.65%	3.52%
Other Services	\$23,689	3.44%	3.70%	2.04%	4.08%	4.04%	3.46%
Retail Trade	\$20,718	3.05%	2.38%	2.42%	2.81%	2.74%	2.59%
Leisure and Hospitality	\$12,442	3.37%	1.06%	3.00%	3.69%	3.57%	2.83%
Agriculture, Forestry, and Fishing	\$5,779	3.05%	3.44%	2.29%	2.37%	2.72%	2.70%
Total	\$25,536	3.31%	4.28%	3.08%	3.03%	3.10%	3.37%

Average annual wages are forecast to grow 0.08% faster in CY 2004 through CY 2007 than they did in CY 1991 through CY 2002. Average wages are forecast to grow fastest in financial activities, information, and the wholesale trade. Average wages are forecast to grow the slowest in the federal government, manufacturing, and retail trade.

Employment in each sector is multiplied by the average wage in each sector to give wage and salary income for each sector. Wage and salary income for the sectors is summed and then the total is adjusted for the difference between wages and salaries reported for income tax and wages and salaries reported for unemployment insurance. From CY 1994 through CY 2003, wages and salaries reported for unemployment insurance grew at an average annual rate of 5.15%. Wages and salaries reported for income tax grew at an average annual rate of 4.94% but varied more from year to year. For each percentage point that growth of wages reported for unemployment insurance exceeds the average of 5.15%, the growth rate of income tax wages exceeds the average of 4.94% by 1.93%.

Table 9 shows total wage and salary income growth in CY 2003 through CY 2007. It also shows wage and salary growth separated into three components: employment growth, inflation, and growth in inflation-adjusted average real wages and salaries.¹

Table 9 Wage and Salary Income Growth				
Calendar Year	Employment	Growth Rate		
		Real Wage and Salary Income per Employee	Inflation	Wages and Salaries
2004	1.66%	2.21%	2.58%	6.59%
2005	2.02%	1.04%	1.82%	4.95%
2006	1.27%	0.63%	1.42%	3.36%
2007	1.24%	0.46%	1.70%	3.44%
Average 2004 - 2007	1.55%	1.34%	1.88%	4.84%
Average 1991 - 2003	2.06%	0.54%	2.56%	5.25%

Employment grew at an average annual rate of 2.06% from CY 1991 through CY 2003. Employment growth is forecast to be slower in CY 2004 through CY 2007, with an average annual growth rate of 1.55%.

Real inflation-adjusted wage and salary income per employee grew only 0.54% per year from CY 1991 through CY 2003. In CY 2004 through CY 2007 it is forecast to grow at an average annual rate of 1.34%. This is slightly less than Global Insight's forecast of national growth of real wage and salary income per employee, 1.37%.

The average inflation rate was 2.56% from CY 1991 through CY 2003. Global insight forecasts that inflation will remain low through CY 2007, with average inflation of 1.88%.

Faster growth in real wage and salary income per employee is expected to be more than offset by slower employment growth and lower inflation. Total wages and salaries are forecast to grow at an average annual rate of 4.84%, about 0.4% lower than the average growth from CY 1991 through CY 2003.

¹ The growth rate of total wages and salaries equals $(1 + \text{real wage and salary per employee growth rate}) \times (1 + \text{inflation rate}) \times (1 + \text{employment growth rate}) - 1$.

Ownership Income

Table 10 shows dividends; net business income; rents, royalties and partnership income; net farm income; and other income reported on full year residents' income tax returns for CY 1995 through CY 2003 and forecasts for CY 2004 through CY 2007.

Table 10 Ownership Income										
CY	Dividends		Net Business Income		Rents, Royalties and Partnership		Net Farm Income		Other Income	
	\$ millions	% chg.	\$ millions	% chg.	\$ millions	% chg.	\$ millions	% chg.	\$ millions	% chg.
A 1995	278.478		551.270		629.647		-95.456		0.918	
A 1996	291.415	4.6%	544.993	-1.1%	645.596	2.5%	-105.452	10.5%	-22.219	-2521.7%
A 1997	323.151	10.9%	554.537	1.8%	664.947	3.0%	-98.433	-6.7%	-36.415	63.9%
A 1998	312.283	-3.4%	584.178	5.3%	709.340	6.7%	-135.309	37.5%	-37.887	4.0%
A 1999	340.081	8.9%	599.189	2.6%	813.250	14.6%	-75.241	-44.4%	-56.774	49.9%
A 2000	374.794	10.2%	606.597	1.2%	894.050	9.9%	-77.473	-3.0%	-32.694	42.4%
A 2001	302.464	-19.3%	617.943	1.9%	917.394	2.6%	-112.633	-45.4%	-22.436	31.4%
A 2002	264.875	-12.4%	620.572	0.4%	1014.593	10.6%	-157.525	-39.9%	-5.377	76.0%
A 2003	297.423	12.3%	629.701	1.5%	1019.724	0.5%	-146.211	7.2%	-47.936	-791.5%
F 2004	314.417	5.7%	646.203	2.6%	1099.276	7.8%	-149.576	-2.3%	-47.936	0.0%
F 2005	318.661	1.3%	664.777	2.9%	1203.911	9.5%	-131.550	12.1%	-47.936	0.0%
F 2006	337.756	6.0%	682.808	2.7%	1275.066	5.9%	-154.045	-17.1%	-47.936	0.0%
F 2007	357.919	6.0%	701.198	2.7%	1381.619	8.4%	-163.224	-6.0%	-47.936	0.0%

* Net Farm Income and Other Income are negative. For display purposes, a change to a smaller negative value is shown as a positive percentage change and a change to a larger negative value is shown as a negative percentage change.

Montana dividends and net business income are highly correlated with their national equivalents. Growth of Montana dividend income is forecast to be a constant proportion to growth of national dividend income. Dividends fell by 19% in CY 2001 and 12% in CY 2002 because of the national recession. In CY 2003, dividend income recovered almost to its CY 2001 level. It is forecast to continue growing from this reduced base.

Net business income is less volatile than dividends. The growth rate of Montana net business income is forecast based on the previous year's growth rate and the growth rate of national proprietors' income. Growth of net business income in Montana slowed in CY 2000 through CY 2002 as the national economy went into a recession. It grew slightly faster in CY 2003 and is projected to grow by between 2.6% and 2.9% in CY 2004 through CY 2007.

The growth rate of rents, royalties and partnership income is forecast based on the growth rate of national rental income and recent differences between actual and predicted growth rates. It is forecast to grow fairly rapidly through CY 2007. Mineral royalties are generally reported in this category, and high oil and natural gas prices will contribute to this growth.

Net farm income has been negative in recent years and is projected to stay negative. Net farm income is forecast using forecasts of beef and wheat prices from the U.S. Department of Agriculture, a time trend, and deviations of recent income from the trend.

The other income line is a catchall for income that does not fit on the other lines. Other income is small and is forecast to be constant.

Retirement Income

Statistical tests were performed to find national data series forecast by Global Insight that are correlated with taxable pensions and IRA distributions and the taxable portion of Social Security reported by full year residents. Taxable pensions and IRA distributions were found to be explained best by last years' S&P 500 stock price index and last year's U.S. gross domestic product and recent differences between actual and predicted pension income. Taxable Social Security is forecast based on Montana population age 65 and older and inflation.

Table 11 shows actual taxable pension and IRA distributions and taxable Social Security for CY 2000 through CY 2003 and forecasts for CY 2004 through CY 2007.

Table 11 Retirement Income				
Calendar Year	Pensions and IRAs		Social Security	
	\$ millions	% change	\$ millions	% change
A 2000	1206.261	8.9%	255.297	16.1%
A 2001	1233.690	2.3%	257.153	0.7%
A 2002	1250.389	1.4%	254.249	-1.1%
A 2003	1307.739	4.6%	267.287	5.1%
F 2004	1353.324	3.5%	282.185	5.6%
F 2005	1432.794	5.9%	293.185	3.9%
F 2006	1500.810	4.7%	303.981	3.7%
F 2007	1570.374	4.6%	316.624	4.2%

Capital Gains and Supplemental Gains

Capital gains and supplemental gains are gains or losses from the sale of assets. Gains or losses on the sale of property used in the owner's trade or business, mineral rights, and business inventories generally are reported as supplemental gains. Gains or losses on the sale of other assets generally are reported as capital gains.

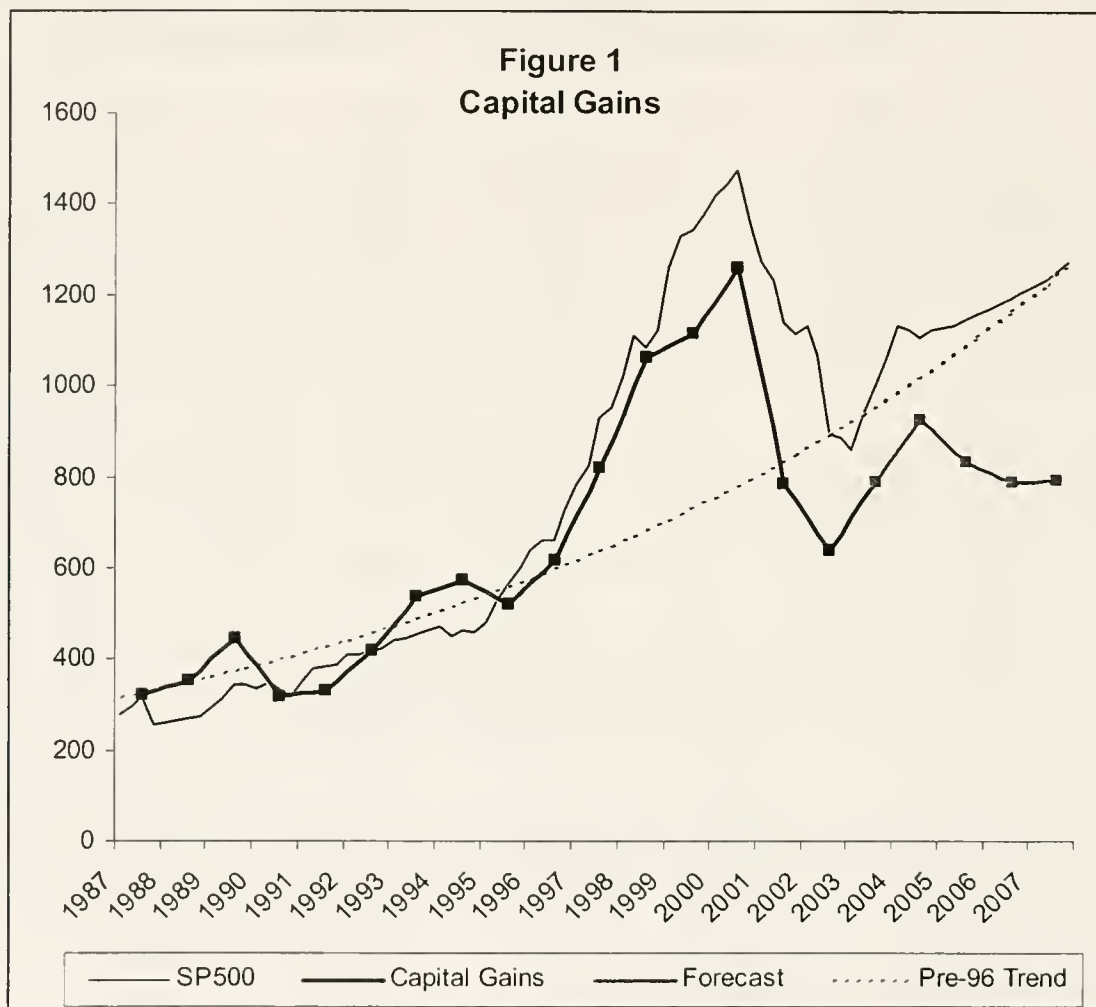
Table 12 shows capital gains and supplemental gains, in millions of dollars and as a percent of income, from CY 1987 through CY 2003. Both show considerable variability with year-to-year changes (up or down) averaging 20% over this period.

Table 12 Capital Gains and Supplemental Gains CY 1987 - CY 2003						
Calendar Year	Capital Gains			Supplemental Gains		
	\$ millions	% chg.	% of Income	\$ millions	% chg.	% of Income
A 1987	322.597		5.33%	17.376		0.29%
A 1988	353.657	9.6%	5.31%	31.293	80.1%	0.47%
A 1989	446.432	26.2%	6.27%	31.831	1.7%	0.45%
A 1990	318.211	-28.7%	4.23%	34.467	8.3%	0.46%
A 1991	331.219	4.1%	4.16%	32.339	-6.2%	0.41%
A 1992	416.698	25.8%	4.83%	32.040	-0.9%	0.37%
A 1993	536.271	28.7%	5.91%	44.765	39.7%	0.49%
A 1994	573.637	7.0%	6.01%	40.441	-9.7%	0.42%
A 1995	521.183	-9.1%	5.24%	36.930	-8.7%	0.37%
A 1996	616.453	18.3%	5.84%	38.126	3.2%	0.36%
A 1997	818.544	32.8%	7.30%	51.468	35.0%	0.46%
A 1998	1060.174	29.5%	8.75%	47.856	-7.0%	0.39%
A 1999	1115.780	5.2%	8.76%	44.391	-7.2%	0.35%
A 2000	1259.720	12.9%	9.16%	46.175	4.0%	0.34%
A 2001	785.759	-37.6%	5.74%	42.906	-7.1%	0.31%
A 2002	637.444	-18.9%	4.65%	32.565	-24.1%	0.24%
A 2003	790.913	24.1%	5.54%	55.547	70.6%	0.39%

Capital gains followed a general upward trend from CY 1990 through CY 2000. During this period, capital gains increased almost four-fold and grew from 4.2% of income to 9.2% of income. This coincided with a prolonged period of economic expansion that culminated in the stock market bubble of the late 1990s. The expansion ended and the stock market crashed in CY 2000, and capital gains fell by almost half from CY 2000 to CY 2002.

Capital gains or losses result when the price of an asset rises or falls between the time it is bought and the time it is sold. Statistical models were estimated relating capital gains to changes in stock prices. Only a portion of capital gains are from sales of stocks, but stocks are the only assets for which reliable price data are available, and most asset values are affected similarly by general economic conditions and investor optimism or pessimism. Thus, stock prices serve as a general indicator of the value of assets. The model that fit the data best predicts capital gains based on an average of the differences between the current value of the S&P 500 stock index and its value in the last eleven years.

Figure 1 shows actual capital gains in CY 1987 through CY 2003, the actual average quarterly S&P 500 in CY 1987 through CY 2003, Global Insight's forecast of the quarterly average S&P 500 through CY 2007, and the annual forecast of capital gains for CY 2003 through CY 2007. It also shows a trend line based on capital gains in CY 1987 through CY 1995, the years immediately before the stock market bubble.



Through CY 1995, stock prices rose steadily. Capital gains varied from year to year, but had about the same average growth as stock prices. From CY 1996 through CY 1999, stock prices rose rapidly. Capital gains rose rapidly in CY 1997 and CY 1998 as many assets were being sold for significantly more than was paid for them. Capital gains growth slowed in CY 1999, before the stock market peaked. Although asset prices continued to rise, an increasing percentage of assets had been purchased after prices had started rising rapidly. Stock prices peaked in CY 2000. They fell rapidly in CY 2001 and CY 2002 and continued to fall, but not as rapidly, in CY 2003. Capital gains fell even more rapidly than stock prices in CY 2001. Not only were selling prices lower, some of the assets being sold had been bought

during the peak years and were being sold for a loss. Capital gains fell more slowly than stock prices in CY 2002. They recovered somewhat in CY 2003 as the stock market recovered and investors began selling some of the assets they bought during the trough in CY 2001 and CY 2002. Stock prices continued to rise through the first half of CY 2004, but fell slightly in the third quarter. Stock prices are projected to rise slowly through CY 2007.

Capital gains are projected to be higher in CY 2004 than in CY 2003, reflecting the 25% increase in the S&P 500 from the first quarter of CY 2003 to the second quarter of CY 2004. They are projected to be close to the CY 2003 level in CY 2005 through CY 2007 as stock prices rise slowly. Capital gains are projected to remain well below the pre-stock-bubble trend through CY 2007 even though asset prices are projected to be rising and close to the trend. A significant percentage of assets sold during the next few years will have been bought at inflated prices between CY 1996 and CY 2001 and will be sold for a loss or minimal gain.

Supplemental gains follow the same cycles as capital gains but follow them differently. Cycles in the capital gains growth rate have long, smooth peaks and short, sharp troughs. Cycles in the supplemental gains growth rate have short sharp peaks and long smooth troughs. The growth rate of supplemental gains is forecast using the forecast growth rate for capital gains and an indicator variable for peaks in the capital gains cycle. Table 13 shows the forecasts of capital gains and supplemental gains for CY 2004 through CY 2007.

Table 13 Capital and Supplemental Gains Forecasts				
Calendar Year	Capital Gains		Supplemental Gains	
	\$ millions	% chg.	\$ millions	% chg.
F 2004	926.935	17.2%	53.420	-3.8%
F 2005	831.049	-10.3%	49.492	-7.4%
F 2006	786.957	-5.3%	46.203	-6.6%
F 2007	794.154	0.9%	43.462	-5.9%

Interest Income

Interest earnings depend on taxpayers' savings and interest rates. Statistical models were estimated to find relationships between interest income, various short- and long-term interest rates, and indicators of economic activity. The model that fits the data best predicts interest earnings using a time trend to capture the growth in taxpayers' savings, the current and last year's average rates on three-month certificates of deposit, and differences between recent interest income and predicted values.

Table 14 shows actual interest income and interest rates on three-month certificates of deposit for CY 1995 through CY 2003 and forecasts through CY 2007. Interest income decreased by 20% in CY 2002 and 14% in CY 2003 as interest rates fell. It is projected to decline in CY 2004 because interest rates continued to fall in CY 2003 and then stayed low. Interest income is forecast to increase in CY 2005 through CY 2007, but still to be lower in CY 2007 than in CY 1995 through CY 2002.

Table 14 Interest Income			
Calendar Year	3 Month CD Rate	Interest Income	
		\$ millions	% chg.
A 1995	5.92%	550.441	
A 1996	5.39%	589.569	7.1%
A 1997	5.61%	595.108	0.9%
A 1998	5.47%	621.815	4.5%
A 1999	5.32%	602.599	-3.1%
A 2000	6.46%	652.744	8.3%
A 2001	3.73%	662.617	1.5%
A 2002	1.73%	528.959	-20.2%
A 2003	1.15%	453.025	-14.4%
F 2004	1.52%	382.552	-15.6%
F 2005	2.87%	416.515	8.9%
F 2006	3.56%	526.288	26.4%
F 2007	3.67%	538.930	2.4%

Adjustments to Income

A taxpayer's federal adjusted gross income is the sum of the eleven income line items shown above minus adjustments to income, which include un-reimbursed expenses, IRA contributions, and alimony paid. Montana adjusted gross income is federal adjusted gross income plus income that the state taxes but the federal government does not tax, minus income that the federal government taxes but the state does not. Table 15 shows actual growth rates of adjustments to income and income that Montana taxes but the federal government exempts in CY 2001 through CY 2003 and forecasts for CY 2004 through CY 2007.

Table 15 Annual Growth Rates of Adjustments to Income and Income Montana Taxes but Federal Government Exempts				
Year	Adjustments to Income	Out-of-State Municipal Bond Interest	Federal Income Tax Refunds	Other Additions
2001	1.28%	4.78%	10.24%	0.73%
2002	23.21%	-2.97%	21.34%	2.63%
2003	15.69%	4.01%	3.88%	18.14%
2004	6.68%	11.16%	-2.13%	-15.88%
2005	6.68%	5.62%	10.87%	0.00%
2006	6.67%	-2.91%	5.68%	0.00%
2007	6.67%	4.55%	5.37%	0.00%

Adjustments to income are forecast using a time trend.

Income taxable in Montana that is not taxed by the federal government is reported in three categories: interest on municipal bonds from other states, federal income tax refunds, and all other.

Interest on municipal bonds is forecast using the current and last year's average interest rate on municipal bonds, a time trend to account for growth in bond holdings over time, and differences between recent income and predicted values.

Federal income tax refunds are forecast using a time trend and recent deviations from the trend. Beginning in CY 2005, the simulation program reduces the amount of each federal refund that is included in income by the amount that federal taxes paid exceed the cap on deductibility of federal taxes in SB 407.

When taxpayers report income in the all other category, it usually is because they have elected to have income taxed differently at the state and federal level. Other additions to income varies from year to year but shows no trend. It was significantly higher in CY 2003 than in previous years. It is projected to return to the average level in CY 1987 through CY 2003 and then remain at that level.

Table 16 shows actual growth rates of income that Montana exempts but the federal government taxes in CY 2001 through CY 2003 and forecasts for CY 2004 through CY 2007.

Table 16 Annual Growth Rates of Income Montana Exempts but Federal Government Taxes						
Year	Savings Bond Interest	Unemploy- ment Compen- sation	Medical Savings Accounts	Family Education Accounts	First Time Homebuyers Accounts	Other Reductions
A 2001	-12.81%	17.40%	21.63%	61.24%	23.47%	6.46%
A 2002	-30.61%	31.53%	20.56%	60.42%	1.76%	5.44%
A 2003	-20.93%	9.50%	14.70%	20.15%	14.94%	6.83%
F 2004	-8.29%	-29.99%	13.65%	16.58%	13.05%	5.38%
F 2005	9.55%	0.00%	12.01%	14.22%	13.05%	5.38%
F 2006	24.55%	0.00%	10.73%	12.45%	13.05%	5.38%
F 2007	3.70%	0.00%	9.69%	11.07%	13.05%	5.38%

Income that the federal government taxes but Montana does not is reported in nine categories, but only six are shown in Table 16. The interest exclusion for the elderly and exempt retirement are calculated for each return in the simulation program, so that no overall growth rate is forecast for them. The farm risk management account

exemption has only been in effect for two years. With no history to go on, it is forecast to be constant at the CY 2003 level.

Interest on savings bonds is forecast as a growing percentage of interest income.

Unemployment compensation varies over the course of business cycles but does not show a trend. Unemployment compensation was higher than normal in CY 2002 and CY 2003 because of the recession and jobless recovery. Employment is forecast to continue to grow steadily, and unemployment compensation should return to normal levels. CY 2001 is the latest year with normal unemployment compensation. The forecast is for unemployment compensation to be constant at the CY 2001 level, which is 29.99% lower than the CY 2003 level.

Medical savings account and family education account contributions and interest are forecast to increase each year by the average of the last six years' increases.

First time homebuyers account contributions and interest has grown rapidly since this exemption was introduced. It is forecast to grow at the average growth rate from CY 1999 through CY 2003.

Other reductions are forecast to grow at the average of past annual growth rates.

Deductions

Montana taxable income is Montana adjusted gross income less deductions. Many taxpayers claim the standard deduction. Taxpayers who itemize deductions may claim deductions in fourteen categories.

1. Medical insurance premium deductions are forecast to grow at the average rate of growth in recent years.
2. Medical expense deductions are forecast to grow at the average rate of growth in recent years.
3. Deductions for long-term care insurance are forecast to grow by the average amount of growth in recent years.
4. Deductions for federal income tax payments are calculated in the simulation program. This calculation uses growth rates for back year taxes and payments made with returns. Beginning in CY 2005, the calculation incorporates the limits on this deduction in SB 407. Back year taxes are forecast to be constant at the average in CY 1994 through CY 2003 and payments with returns are forecast with a time trend.
5. Deductions for real estate taxes are based on the property tax forecast.
6. Deductions for vehicle taxes are based on the vehicle fees forecast.

7. Mortgage interest deductions are forecast using the average interest rate on 30-year mortgages, the average price of existing houses, and recent differences between actual and predicted deductions.
8. Deductions for investment interest are forecast using a trend, the interest rate on three-month certificates of deposit, and recent differences between actual and predicted deductions.
9. Deductions for charitable contributions are forecast using a trend and recent differences between actual and predicted deductions.
10. Deductions for child and dependent care expenses are forecast using a trend and recent differences between actual and predicted growth rates.
11. Deductions for casualty and theft losses are forecast to grow by the average amount of growth in recent years.
12. Deductions in the first miscellaneous category are forecast to grow by the average amount of growth in recent years.
13. Deductions in the second miscellaneous deduction category are forecast using a trend and recent differences between actual deductions and the trend.
14. Deductions for gambling losses are forecast to be constant at the CY 2003 level.

Table 17 shows actual growth rates of itemized deduction line items for CY 2001 through CY 2003 and forecasts for CY 2004 through CY 2007.

Table 17 Annual Growth Rates of Itemized Deductions					
CY	Medical Insurance Premiums	Medical and Dental Expenses	Long Term Care Insurance	Federal Income Tax Paid with Return	Back Year Federal Taxes
A 2001	8.97%	9.95%	4.14%	2.51%	61.28%
A 2002	9.89%	9.71%	12.98%	-21.55%	-31.92%
A 2003	-1.99%	6.12%	8.86%	-5.09%	-7.46%
F 2004	5.17%	8.24%	7.74%	2.91%	-4.76%
F 2005	5.17%	8.24%	7.18%	2.82%	0.00%
F 2006	5.17%	8.24%	6.70%	2.75%	0.00%
F 2007	5.17%	8.24%	6.28%	2.67%	0.00%

Year	Real Estate Taxes	Vehicle Taxes	Mortgage Interest	Investment Interest	Contributions
A 2001	3.70%	-18.12%	7.03%	-9.45%	3.57%
A 2002	10.66%	11.63%	4.15%	-22.57%	13.05%
A 2003	5.99%	3.00%	-1.05%	-12.23%	-2.26%
F 2004	4.17%	3.00%	14.79%	-2.80%	7.50%
F 2005	4.29%	3.00%	11.37%	16.68%	13.18%
F 2006	4.37%	3.00%	10.97%	-5.19%	13.75%
F 2007	4.48%	3.00%	4.56%	8.12%	9.28%

CY	Child and Dependent Care Expenses	Casualty and Theft Losses	Miscellaneous I	Miscellaneous II	Gambling Losses
A 2001	-7.59%	-56.20%	9.07%	-0.26%	-14.98%
A 2002	1.57%	41.33%	3.81%	13.45%	0.14%
A 2003	2.18%	-8.03%	0.45%	67.50%	-3.55%
F 2004	2.84%	3.79%	3.83%	-28.97%	0.00%
F 2005	-5.67%	3.65%	3.69%	10.70%	0.00%
F 2006	-2.86%	3.52%	3.56%	7.68%	0.00%
F 2007	-3.08%	3.40%	3.44%	6.95%	0.00%

Population Growth

The simulation program estimates future years' tax liability for taxpayers who filed returns for the last tax year. This must be adjusted for growth in the number of taxpayers. Statistical analysis shows that growth in the number of tax returns filed by full year residents is highly correlated with employment growth. When employment increases by 1,000, the number of full year resident tax returns

increases by 892. Table 18 shows employment and the number of full year resident returns for CY 1990 through CY 2003 and projections for CY 2004 through CY 2007. The employment projections were developed as part of the wage and salary income estimates explained above.

Table 18 Employment and Full Year Resident Returns				
CY Year	Employment	% chg.	Returns	% chg.
A 1990	297,242		391,191	
A 1991	303,608	2.14%	403,343	3.11%
A 1992	316,558	4.27%	413,634	2.55%
A 1993	325,608	2.86%	419,274	1.36%
A 1994	340,142	4.46%	431,778	2.98%
A 1995	350,733	3.11%	442,031	2.37%
A 1996	360,308	2.73%	449,231	1.63%
A 1997	364,892	1.27%	452,703	0.77%
A 1998	373,083	2.24%	459,441	1.49%
A 1999	380,308	1.94%	468,417	1.95%
A 2000	387,583	1.91%	479,971	2.47%
A 2001	391,733	1.07%	479,444	-0.11%
A 2002	396,000	1.09%	482,021	0.54%
A 2003	399,667	0.93%	484,363	0.49%
F 2004	407,064	1.85%	492,247	1.63%
F 2005	415,583	2.09%	499,845	1.54%
F 2006	421,073	1.32%	504,743	0.98%
F 2007	426,450	1.28%	509,539	0.95%
1990-1996 average		3.26%		2.33%
1996-2002 average		1.59%		1.18%
2002-2007 average		1.24%		0.93%

Changes to State and Federal Tax Law

The simulation program calculates future tax liability for last year's full year resident returns assuming that individual line items grow as explained above. There are two types of adjustments that must be made to the program for each future year. One is to accommodate the fact that parts of both state and federal tax law, including rate tables and standard deductions, are indexed for inflation. The other is to accommodate changes in tax law. Significant changes in both state and federal tax law will take effect between CY 2003 and CY 2007. The changes in state law are the result of SB 407 (2003 session). Changes to federal tax law are the result of the Job Creation and Worker Assistance Act of 2002 (JCWAA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). Changes to federal rate tables, deductions and credits are incorporated into the simulation program. The bonus depreciation provisions of JCWAA and JGTRRA affect the way that business income

is measured, not how it is taxed. Thus, an estimate of the impact of bonus depreciation was made separately and used to adjust the output of the simulation program.

The JCWAA and JGTRRA provide for temporary changes in business depreciation schedules. For depreciable equipment purchased between January 1, 2003 and May 5, 2003, the first year's depreciation is the amount from the normal depreciation schedule plus 30% of the original cost. Depreciation in the second year and for the rest of the asset's life is based on the normal schedule applied to the un-depreciated amount remaining after the first year. For equipment purchased between May 6, 2003 and December 31, 2004, businesses can choose between 30% and 50% extra depreciation in the first year. This does not change the total amount of depreciation that can be deducted in calculating a business's income. It just shifts depreciation to CY 2003 and CY 2004 from later years. Since depreciation is deducted from revenue in calculating income, bonus depreciation shifts income and taxes from CY 2003 and CY 2004 to later years.

The Department of Revenue examined depreciation schedules filed with three years of corporation license tax returns and recalculated tax liability for these returns as if bonus depreciation had been in effect for those years. The difference in liability was used to estimate the effect of bonus depreciation on both corporation license tax and business income reported on individual income tax returns. The right-hand column of Table 19 shows the estimated impact of bonus depreciation on income tax revenue in FY 2002 through FY 2007.

Table 19
Revenue Impact of Bonus Depreciation

Fiscal Year	Revenue Impact (\$ millions)
2002	(1.493)
2003	(2.526)
2004	(1.734)
2005	0.339
2006	1.833
2007	1.428

Calendar Year Tax Liability

The simulation program calculates tax liability for each return in the income tax database using the income and deductions reported on that return. For some returns, this is different from the tax liability reported on the return. The most common reason for this is that a few taxpayers attach copies of their federal returns rather than entering information on the income lines of their state returns. In the database, these returns appear to have no income so that their calculated tax liability is zero.

The first row of Table 20 shows calculated tax liability of \$534.044 million for CY 2003 full year resident returns and actual tax liability reported of \$540.969 million on

those returns. The left half of the second row shows calculated tax liability of \$561.533 million for CY 2004, which is a 5.15% change from CY 2003. The right half of the second row shows the growth rate of 5.15% applied to actual tax on CY 2003 full year resident returns to give forecast CY 2004 tax for full year residents of \$568.815 million. The remaining rows show the same calculation for CY 2005 through CY 2007.

Table 20 CY 2004 - CY 2007 Tax Liability - Full Year Residents Calculated from CY 2003 Returns				
Calendar Year	Calculated Tax Liability		Actual 2003 Tax plus Growth	
	\$ million	% Change	\$ million	% Change
2003	534.044	-	540.969	-
2004	561.533	5.15%	568.815	5.15%
2005	536.080	-4.53%	543.032	-4.53%
2006	538.176	0.39%	545.155	0.39%
2007	545.789	1.41%	552.867	1.41%

Even though income is forecast to grow each year, calculated tax liability drops by 4.5% in CY 2005 because of the rate reductions in SB 407.

A regression model was estimated to determine the relationship between tax liability of all taxpayers and the liability of full year residents. The model that fit the data best predicts that in CY 2004 tax liability of all taxpayers will be \$25.126 million less than 111.30% of full year residents' liability and that the difference from 111.30% will increase by \$0.852 million each year. Table 21 shows the calculation of tax liability for all taxpayers for CY 2004 through CY 2007 based on CY 2003 returns.

Table 21 CT 2004 - CY 2007 Tax Liability of All Taxpayers Calculated from CY 2003 Returns (\$ millions)						
Calendar Year	2003 Full Year Resident's Liability					All 2003 Taxpayers' Liability
F 2004	568.815	x	111.30%	-	-25.126	= 607.975
F 2005	543.032	x	111.30%	-	-25.978	= 578.427
F 2006	545.155	x	111.30%	-	-26.829	= 579.938
F 2007	552.867	x	111.30%	-	-27.681	= 587.670

Total tax liability for each year is the liability for all taxpayers based on CY 2003 returns, calculated in Table 21, adjusted for growth of returns, calculated from the growth rates in Table 18. Tax for each year is this liability minus credits. This is shown in Table 22.

Table 22 Calendar Year Tax Liability (\$ millions)							
Year	Total Liability with Fixed Population		Ratio of Returns to 2003 Returns	Total Tax Liability	Home- owner / Renter Credit	Other Credits	Tax
F 2004	607.975	x	1.016	= 617.871	- 12.360	- 21.169	= 584.342
F 2005	578.427	x	1.032	= 596.916	- 12.706	- 22.096	= 562.114
F 2006	579.938	x	1.042	= 604.339	- 13.061	- 23.198	= 568.080
F 2007	587.670	x	1.052	= 618.215	- 13.427	- 24.321	= 580.468

The low-income homeowner renter credit is claimed on tax returns or on a separate form for persons who are not required to file income tax returns. The number of persons claiming this credit grew much faster in CY 2003 than in previous years. The number of people claiming the credit is forecast to grow at the average rate from CY 1996 through CY 2001. The average credit claimed is forecast to grow at the average rate from CY 1997 through CY 2003.

Two other credits are estimated individually. The credit for taxes paid to other states accounts for almost 75% of the amount of other credits. It has grown fairly steadily over time and is forecast to continue to grow by the average increase over CY 1990 through CY 2002. The credit for contributions to a charitable endowment is expected to be the largest other credit. HB 616 (2003 session) changed the percentage of a gift that can be claimed as a credit and the maximum credit. The credit is forecast by applying the percentage changes in the fiscal note for that bill to actual credits claimed in CY 2003. All other credits are forecast to grow at 6.53% per year, which is the average growth rate over the last five years with the effects of law changes removed.

Allocate Calendar Year Liability to Fiscal Years

It has been estimated that collections in a fiscal year are equal to 52.1% of collections in the current calendar year and 47.9% of collections in the previous calendar year. Table 23 shows the

Table 23 Fiscal Year Tax Liability		
Fiscal Year	Tax Liability	Growth Rate
F 2004	563.594	
F 2005	572.761	1.63%
F 2006	565.223	-1.32%
F 2007	574.534	1.65%

calendar year tax liability calculated in Table 22 allocated to fiscal years and the annual growth rate. The drop in tax liability in CY 2005 is spread over two fiscal years, and there is minimal growth in calculated tax liability from FY 2004 to FY 2006.

Add Audit Revenue and Other Adjustments

The annual growth rates of fiscal year liability in Table 23 are applied to the latest actual fiscal year collections and then three adjustments are made to give the forecast of fiscal year collections. The first adjustment is for audit revenue and other collections that are not associated with tax returns. The second adjustment is for the effects of the federal bonus depreciation allowance. The third adjustment is for the transition to new tax rates under SB 407.

Table 24 shows the calculation of fiscal year collections. The first row shows actual FY 2004 collections of \$605.582 million in the sixth column. Audit revenue, penalty and interest and prior year payments were \$29.922 million, and bonus depreciation is estimated to have reduced revenue by \$1.734 million. Revenue before audit and adjustments, shown in the second column, is calculated by subtracting audit, penalty and interest, and prior year revenue from collections and adding back the revenue loss from bonus depreciation. The result, \$577.394 million, is used as the base for the forecast. Revenue before audit and adjustments for FY 2005 through FY 2007 is calculated by applying the growth rates in Table 23 to this base. Then, audit, penalty and interest, prior year revenue, the effect of bonus depreciation, and the SB 407 transition adjustment are added to give the forecast of collections, which is shown in the sixth column. Debt service payments for the Department of Revenue's new data processing system are deducted from income tax collections. These are shown in the seventh column, and net revenue to the general fund is shown in the right-hand column.

Table 24
Forecast Collections and Allocation
(\$ millions)

Fiscal Year	Revenue Before Audit and Adjustments		Audit, Penalty and Interest, Prior Year		Bonus Depreciation Adjustment		SB 407 Transition		Forecast Collections		DOR Debt Service		General Fund
A 2004	577.394	+	29.922	-	1.734			=	605.582	-	0.234	=	605.348
F 2005	586.785	+	21.400	+	0.339	+	8.019	=	616.543	-	1.276	=	615.267
F 2006	579.062	+	23.400	+	1.833	-	8.019	=	596.276	-	2.774	=	593.502
F 2007	588.602	+	28.400	+	1.428			=	618.430	-	3.183	=	615.247

The estimate of audit revenue is based on the Department of Revenue's experience of revenue per auditor and the number of FTE expected to be devoted to auditing

income tax. Penalty and interest is expected to be proportional to audit revenue. Prior year revenue is projected to be constant at its FY 2004 level.

As explained above, bonus depreciation allows companies to shift profits from CY 2002, CY 2003, and CY 2004 to later years. The returns in the CY 2003 database incorporate the reduction in taxable income from bonus depreciation in CY 2003. Because of this, future tax liability calculated from CY 2003 returns understates tax liability by the difference in the effect of bonus depreciation. This is corrected by adding back the revenue loss in FY 2004 and then adding the revenue gain in later years. The adjustment increases through FY 2006 and then begins to decrease.

As shown in Table 5, SB 407 is expected to reduce tax liability by \$21.841 million in FY 2005. The Department of Revenue will implement new withholding tables January 1, 2005. The new withholding tables will reduce withholding by \$13.822 million in the last half of FY 2005. This is \$8.019 million less than the reduction in tax liability.

About two-thirds of income is from wages and salaries that are subject to withholding. The reduction in withholding is approximately equal to the reduction in tax liability from labor income. About one-third of income is from non-labor sources and is not subject to withholding. Taxpayers with significant amounts of non-labor income are required to make quarterly estimated tax payments or to have extra tax withheld from their labor income. Few taxpayers are likely to adjust their estimated payments or additional withholding for SB 407 until they have filed at least one tax return with the lower rates. Thus, the lower tax liability on non-labor income will not affect state revenue until tax returns are filed in the spring of 2006 and taxpayers with non-labor income request refunds that are \$8.019 million higher.

To adjust for the timing of the impact of SB 407 on non-labor income, collections are increased by \$8.019 million in FY 2005 and reduced by \$8.019 million in FY 2006.

Collections and Revenue

Collections are projected to increase by \$10.961 million (1.8%) in FY 2005, decrease by \$20.267 million (3.3%) in FY 2006, and increase by \$22.154 million (3.7%) in FY 2007. After deducting the Department of Revenue's debt service payments, income tax revenue to the general fund is projected to be \$615.267 million in FY 2005, \$593.502 million in FY 2006, and \$615.247 million in FY 2007.

PROPERTY TAX

Revenue Description

Total property tax revenue is collected directly from property tax revenues generated by mills levied on property, and indirectly from non-levy revenue sources.

Currently, the state general fund receives property tax revenue from mill levies of 22, 33, and 40 mills (95 mill levy) that are levied statewide, and 1.5 mills (vo-tech) levied on property in counties where colleges of technology reside (Silver Bow, Cascade, Yellowstone, Missoula, and Lewis and Clark). The 22, 33, 40, and 1.5 mill levies are subject to the property tax revenue limitations in 15-10-420, MCA. In general, the limitation states that property tax revenue for the current year cannot exceed property tax revenue generated in the prior year, plus an adjustment for one-half the rate of inflation and property tax from new construction.

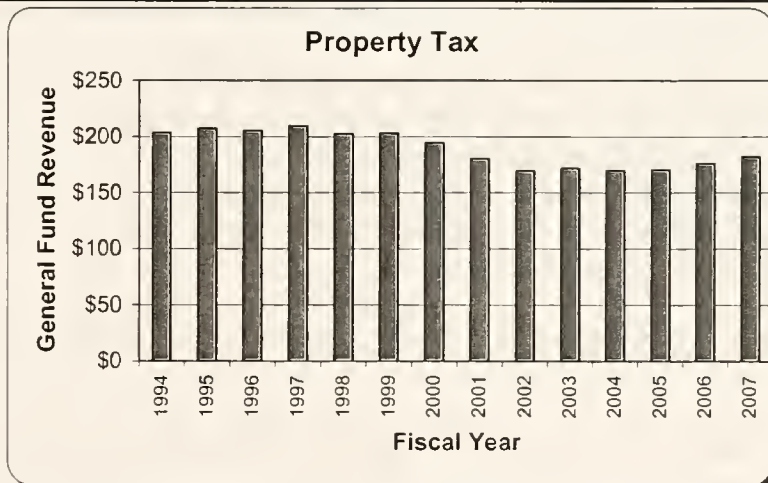
Non-levy revenue is received from sources other than a direct property tax mill levy. Generally, non-levy revenues are distributed to taxing jurisdictions based on the relative share of the total mills levied by all affected taxing jurisdictions. Non-levy revenue is from coal gross proceeds, federal forest receipts, and other smaller revenue sources.

Historical and Projected Revenues

Table 1 shows historical and projected general fund property tax collections for FY 1994 through FY 2007.

Table 1
Property Tax - General Fund Revenue Estimate
(\$ millions)

Fiscal Year	General Fund	Percent Change
A 1994	\$203.357	-2.49%
A 1995	\$206.857	1.72%
A 1996	\$205.111	-0.84%
A 1997	\$209.284	2.03%
A 1998	\$202.350	-3.31%
A 1999	\$202.774	0.21%
A 2000	\$194.197	-4.23%
A 2001	\$180.050	-7.28%
A 2002	\$169.339	-5.95%
A 2003	\$171.657	1.37%
A 2004	\$169.531	-1.24%
F 2005	\$170.077	0.32%
F 2006	\$175.807	3.37%
F 2007	\$181.990	3.52%



From FY 1994 to present, numerous changes to property taxes have occurred where some property was removed from taxable status, some sources of non-levy revenue were removed and accounted for separately, new property classes created, tax rates revised, and so on.

More recently, SB 294 (2003 session) required the counties to forward the state's share of protested taxes; including prior year protested taxes that the counties were holding for centrally assessed companies, to the state. The majority of these protested taxes were received in FY 2003, some were received in FY 2004, and about \$500,000 will be received in FY 2005. These protested tax payments cause revenue to be higher for FY 2003 and FY 2004.

With all these changes from year to year, the revenue changes and percent changes shown in Table 1 do not reflect an actual trend in property tax growth. For instance, removing the prior year protested payment amounts from FY 2003 and FY 2004 would make the change from FY 2002 through FY 2007 more uniform.

Forecast Methodology and Projection Calculation

The property tax projection is a combination of several forecasts. As noted above, revenue for this source comes from property tax mill levies and from non-levy revenue sources. The methodology used to forecast the revenue from the property tax mill levies involves estimating taxable values and making appropriate adjustments. Since revenues are estimated on a fiscal year basis, the revenue estimates for property tax will be based on the taxable value available for each fiscal year. The methodology used to forecast revenue from non-levy revenue sources relies on estimates of each particular revenue source. A final adjustment is made for protested property tax refunds.

Property Tax Mill Levy Revenue

There are five steps to calculate the property tax revenue generated from the 95 total mill levy and the 1.5 mill levy. They are: 1) estimate the growth rate for each class of property; 2) determine the applicable tax rate; 3) calculate the statewide fiscal year taxable value for each class of property; 4) determine the appropriate taxable value for the 95 and 1.5 mill levies, and the revenue deductions to be made to the 95 mill property tax revenue; and 5) calculate the general fund property tax revenue for the 95 and 1.5 mill levies.

Step 1: Estimate the Growth Rate for Each Class of Property

The first step in the process is to estimate growth rates for the taxable value of each property class. Historical valuation trends are generally used as the foundation for estimating future growth; adjustments are then made with the assistance of the Department of Revenue's (DOR) appraisal staff. The adjustments consider knowledge

of future construction projects, the affects of changes in tax rates or depreciation factors, along with professional judgment. A single growth rate is determined for classes 1, 2, 7, and 10 as a group. Separate growth rates are determined for classes 3, 4, 5, 8, 9, 12, and 13. An explanation of how the growth rates are determined follows.

Growth Rate for Classes 1, 2, 7, and 10

Although this group comprises four of the eleven classes of property, it represents less than 1.5% of the total taxable valuation in tax year 2004. The classes included in this group are classes 1 and 2 (net and gross proceeds of mines), class 7 (non-centrally assessed utilities), and class 10 (forest land). The total valuation of this group of property has changed very little since 1996, as shown in Table 2. In tax year 1996, the taxable value of this group was \$25,794,176. In tax year 2004 the taxable value was \$26,226,412. From 1996 to present, the valuation of this group of property has an absolute change of 1.7%, decreasing five times and increasing three times. Considering that the value of these classes has remained at a near neutral level since 1996, a 0% growth rate will be used to project future taxable value for each class of property in this group.

Table 2
Combined Taxable Value
Classes 1, 2, 7, and 10

Tax Year	Taxable Value	Annual % Chg.
1996	\$ 25,794,176	
1997	\$ 24,970,912	-3.2%
1998	\$ 25,864,878	3.6%
1999	\$ 25,710,340	-0.6%
2000	\$ 22,504,656	-12.5%
2001	\$ 27,245,683	21.1%
2002	\$ 26,747,376	-1.8%
2003	\$ 24,392,016	-8.8%
2004	\$ 26,226,412	7.5%

The Effects of Reappraisal and SB 461 on Class 3 and Class 4 Growth

As Table 3 and 4 will show, reappraisal values for class 3 agricultural land and class 4 residential and commercial real property increased significantly in tax year 2003. Tax year 2003 was a reappraisal year in the six-year reappraisal cycle for class 3 agricultural land, class 4 residential and commercial real property, and class 10 forest land. All three classes of property affected by the new reappraisal saw considerable changes in reappraisal values in tax year 2003. However, SB 461 (2003 session) mitigated the impacts due to reappraisal by adjusting the tax rates and exemption levels for classes 3 and 4. Under the provisions of SB 461, the total taxable value for classes 3 and 4 will not increase due to reappraisal; only natural growth or decline should affect taxable values. The growth rates for class 3 and class 4 are projected using historical information without the tax year 2003 reappraisal impacts.

Growth Rate for Class 3 (Agricultural Land)

Logically, there should be no growth of agricultural land. In fact, given the subdivision of agricultural land into residential land, one could expect the growth rate of agricultural land to be slightly negative. Historical reappraisal values substantiate the notion that agricultural land is declining. As Table 3 indicates, agricultural land is declining at approximately -0.1% a year. This average change of -0.1% is used to project taxable values of agricultural land into future years.

Table 3 Full Reappraisal Value Class 3		
Tax Year	Full Reappraisal	Annual % Chg.
1999	\$3,884,767,572	
2000	\$3,851,609,063	-0.9%
2001	\$3,847,752,357	-0.1%
2002	\$3,845,602,698	-0.1%
2003	\$4,477,138,879	16.4%
2004	\$4,470,737,962	-0.1%

Growth Rate for Class 4 (Residential and Commercial Real Property)

New construction adds to the valuation of class 4 property. New construction is measured using full reappraisal values. Full reappraisal values can only change from one year to the next under two scenarios: the first being if there is new construction/destruction, and the second occurs when new property appraisals are determined by the department every six years (six-year reappraisal cycle).

As is evident in Table 4, tax year 2003 was a reappraisal year. Because new property appraisals include property appreciation as well as new construction, tax year 2003 full reappraisal values of class 4 are not included in the trend to estimate future growth. Historically, the growth in class 4 property has experienced little variation. As seen in Table 4, full reappraisal values over the last reappraisal cycle (1997 to 2002) increased steadily, with an average annual growth rate of 4.0%. The change from 2003 to 2004 was an increase of 3.7%; this growth rate is similar to the average annual rate observed during the last reappraisal cycle. The historical average annual growth rate of 4.0% is used to project class 4 residential and commercial real property.

Table 4 Full Reappraisal Value Class 4		
Tax Year	Full Reappraisal	Annual % Chg.
1997	\$ 33,202,404,844	
1998	\$ 34,489,060,057	3.9%
1999	\$ 35,837,770,990	3.9%
2000	\$ 37,354,345,936	4.2%
2001	\$ 38,622,120,375	3.4%
2002	\$ 40,339,606,380	4.4%
2003	\$ 50,621,939,423	25.5%
2004	\$ 52,506,359,937	3.7%

Growth Rate for Class 5 (Rural Co-operatives and Pollution Control)

Table 5 displays the assessed value of class 5 property over an eight-year period. SB 111 (1999 session) exempted all intangible personal property, phasing out intangible personal property valuations over a three-year period from tax year 2000 through 2002. SB 111 affected classes 5, 9, 12, and 13.

To project future growth in classes 5, 9, 12, and 13, the value of intangible personal property is included in the assessed values for tax years 2000, 2001, and 2002. Including the amount of exempt intangible property provides an annual change of comparable, or *like property* from tax year 1996 through 2002. The left-hand side of Table 5 displays the assessed value of class 5 property, and the annual change *including* exempt intangible property. The right-hand side of Table 5 shows actual assessed values of class 5 for tax years 2002 through 2004. Since tax year 2002 is the first year the exemption of intangible property is fully implemented, or phased-out, tax year 2002 and subsequent years do not include any intangible property values.

Table 5 Assessed Value - Class 5				
Tax Year	Includes Intangibles		Without Intangibles	
	Assessed Value	Annual % Chg.	Assessed Value	Annual % Chg.
1996	\$1,080,500,187			
1997	\$1,155,932,959	7.0%		
1998	\$1,151,307,080	-0.4%		
1999	\$1,247,614,156	8.4%		
2000	\$1,260,687,133	1.0%		
2001	\$1,235,677,334	-2.0%		
2002	\$1,271,962,331	2.9%	\$1,180,181,662	
2003			\$1,090,984,237	-7.6%
2004			\$1,134,276,890	4.0%

The average annual change from tax year 1996 through 2002 was an increase of 2.7%. The annual change from 2002 through 2004 was a *decrease* of 2.0%. As Table 5 illustrates, the 7.6% decrease from 2002 to 2003 was somewhat offset by the 4.0% increase in value in tax year 2004. Because the value of class 5 co-operatives and pollution control property, over the long term, has remained nearly constant, an annual change of 0.0% is used to calculate value in subsequent years.

Growth Rate for Class 8 (Business Equipment)

When examining historical assessment levels of class 8 business equipment to estimate a growth rate, there are additional factors to account for beyond total assessment levels. For example, over the years some property has been removed from class 8, such as trucks, buses, and trailers.

SB 200 (1999 session) changed the composition of class 8 by exempting from property taxation the class 8 property of those entities owning \$5,000 or less of class 8 property. Owners of class 8 property with a market value of \$5,000 or less accounted for approximately 1.5%, or about \$50 million, of the total market value of class 8 in tax year 1999.

In this analysis and in Table 6, with the exception of the exemption allowed under SB 200, property types are removed over the years so each year only includes like property for comparison. The exemption allowed under SB200 is not adjusted in this analysis because the actual value of those properties in years other than tax year 1999 is unknown.

When calculating the estimated growth of class 8, an adjustment to the historical comparison is made for the Ramsay TIF in Silver Bow County. Beginning in 1998, one company in the Ramsay TIF district has made large investments in business equipment. There are two reasons to isolate this property when projecting class 8 growth. First, this event is highly unusual and can be considered an outlier. Second, the value of the property is in the incremental taxable value of a TIF district; and, therefore, the state does not receive the 95 mill levy property tax revenue from this investment. Excluding this property from the total statewide market value will be more reflective of the overall growth of class 8 property in the state. An additional explanation of TIF incremental taxable values is found later in this report.

Table 6 Assessed Value - Class 8 Business Equipment				
Tax Year	Assessed Value	Attributed to Outlier	Net Assessed Value	Annual % Chg.
1991	\$ 2,444,920,187	-	\$ 2,444,920,187	
1992	\$ 2,490,280,289	-	\$ 2,490,280,289	1.9%
1993	\$ 2,654,915,833	-	\$ 2,654,915,833	6.6%
1994	\$ 2,855,329,678	-	\$ 2,855,329,678	7.5%
1995	\$ 2,965,921,272	-	\$ 2,965,921,272	3.9%
1996	\$ 2,977,378,990	-	\$ 2,977,378,990	0.4%
1997	\$ 3,081,704,585	-	\$ 3,081,704,585	3.5%
1998	\$ 3,507,976,378	\$ 276,936,268	\$ 3,231,040,110	4.8%
1999	\$ 3,703,236,176	\$ 358,985,202	\$ 3,344,250,974	3.5%
2000	\$ 3,727,546,491	\$ 351,528,681	\$ 3,376,017,810	0.9%
2001	\$ 3,943,691,027	\$ 375,349,663	\$ 3,568,341,364	5.7%
2002	\$ 4,012,212,828	\$ 351,473,759	\$ 3,660,739,069	2.6%
2003	\$ 3,995,585,302	\$ 352,776,622	\$ 3,642,808,680	-0.5%
2004	\$ 3,989,981,886	\$ 195,577,815	\$ 3,794,404,071	4.2%

The annual changes in the assessed value of business equipment, along with the value attributed to the outlier mentioned above, are shown in Table 6. Notice that the overall value of class 8 actually decreased from tax year 2003 to 2004. However, the outlier TIF district saw a significant decrease in value of over \$140 million that is not included in the state's portion of taxable property, or the anticipated growth rate. With the exception of tax year 2003, the change in assessed values net of the outlier is positive each year. The average annual change from tax year 1991 to 2004 is an average increase of 3.4%.

Federal bonus depreciation under sections '1938' through '1944' of the federal Internal Revenue Code sunsets January 1, 2005. It is expected that businesses will alter their buying patterns to take advantage of the final year of bonus depreciation by purchasing business equipment early in tax year (calendar) 2004, purchases that normally would have been made in the following year (2005). For purposes of this analysis, an adjustment of 15% is applied to the annual average growth rate of 3.4% to project future growth in class 8. Adjusting tax year 2005 by an additional 15% yields an estimated growth rate of 3.9% ($3.4\% \times 115\%$). Adjusting tax year 2006 downward by 15% yields an estimated growth rate of 2.9% ($3.4\% \times 85\%$). These growth rates are used to trend class 8 business equipment forward into tax years 2005 and 2006.

Growth Rate for Class 9 (Non-Electric Generation Property of Electric Utilities)

Beginning in tax year 2000, HB 128 and HB 174 (1999 session) removed telecommunication and electric generation property from class 9 and placed it into class 13. Table 7 displays the assessed value of class 9 property since HB 128 and HB 174 were implemented in tax year 2000.

SB 111 (1999 session) exempted all intangible personal property, phasing out intangible personal property valuations from tax year 2000 through 2002. To project future growth of class 9 property, the value of intangible personal property is included in the assessed values for tax years 2000, 2001, and 2002. Including the amount of exempt intangible property provides an annual change of comparable, or *like property* from tax year 2000 through 2002. The left-hand side of Table 7 displays the assessed value of class 9 property and the annual change *including* exempt intangible property. The right-hand side of Table 7 shows actual assessed values of class 9 in tax years 2002, 2003, and 2004.

Table 7 Assessed Value - Class 9				
Tax Year	Includes Intangibles		Without Intangibles	
	Assessed Value	Annual % Chg.	Assessed Value	Annual % Chg.
2000	\$1,940,196,519			
2001	\$1,938,781,826	-0.1%		
2002	\$1,872,507,744	-3.4%	\$1,719,851,111	
2003			\$1,767,716,825	2.8%
2004			\$1,833,334,211	3.7%

As shown in Table 7, the annual change from tax years 2002 to 2003, and 2003 to 2004, are increases of 2.8% and 3.7% respectively. However, these changes are artificially high due to one-time investments. When one-time investments are removed from the tax year 2003 and 2004 totals, there is little growth. In fact, when a single one-time investment is removed from tax year 2003, the change from 2002 to 2003 is actually a *decline* of 2.0%. This reduction in value is representative of prior years. Additionally, the DOR centrally assessed appraisers do not anticipate any additional

value increases in class 9 for tax year 2005 and 2006. Accounting for historical growth, less one-time investments, class 9 is anticipated to decline slightly in future years. A growth rate of -0.1% is used to project class 9 into the future.

Growth Rate for Class 12 (Railroad and Airline Property)

Table 8 shows the assessed value of class 12 railroad and airline property for tax years 1996 to 2004. The assessed values listed on the left-hand side of Table 8 for tax years 2000 through 2002 include the value of previously taxable intangible personal property of class 12. Including the amount of exempt intangible property provides an annual change of comparable property from tax year 1999 to 2002. The right-hand side of Table 8 shows actual assessed values of class 12 from 2002 through 2004 without intangible property values.

Table 8 Assessed Value - Class 12				
Tax Year	Includes Intangibles		Without Intangibles	
	Assessed Value	Annual % Chg.	Assessed Value	Annual % Chg.
1996	\$ 1,022,487,417			
1997	\$ 1,078,114,897	5.4%		
1998	\$ 1,057,796,998	-1.9%		
1999	\$ 1,121,329,900	6.0%		
2000	\$ 1,168,479,418	4.2%		
2001	\$ 1,200,209,266	2.7%		
2002	\$ 1,229,203,626	2.4%	\$ 1,161,404,952	
2003			\$ 1,176,037,585	1.3%
2004			\$ 1,183,046,155	0.6%

The average annual change from 1996 through 2002 was 3.1%. However, since tax year 2002, the first year intangible property was fully exempt, the average annual growth rate has been 0.9%. The more recent growth rate of 0.9% is the annual growth rate used to trend class 12 railroad and airline property forward.

Growth Rate for Class 13 (Telecommunications and Electric Generation)

Class 13 was created in tax year 2000 by HB 128 and HB 174 (1999 session). The legislation removed telecommunication and electric generation property from class 9 and placed it into class 13. Table 9 displays the assessed value of class 13 property since its creation in tax year 2000. The assessed values listed on the left-hand side of Table 9 for tax years 2000 through 2002 include the value of exempt intangible personal property of class 13. Including the amount of exempt intangible property provides an annual change of comparable property from tax year 2000 to 2002. The right-hand side of Table 9 shows actual assessed values of class 13 from tax years 2002 to 2004 without intangible property values.

Table 9 Assessed Value - Class 13				
Tax Year	Includes Intangibles		Without Intangibles	
	Assessed Value	Annual %Chg.	Assessed Value	Annual %Chg.
2000	\$2,494,795,228			
2001	\$2,608,834,775	4.6%		
2002	\$2,584,822,285	-0.9%	\$2,286,414,106	
2003			\$2,041,207,238	-10.7%
2004			\$2,008,084,452	-1.6%

Historically, telecommunications and electric generation property has increased in value. However, as shown in Table 9, class 13 value has declined since tax year 2002 by more than 13%.

Telecommunications and electric generation both saw significant downturns in their respective industries, which subsequently lowered their annual appraisals. Preliminary indications are that the value of class 13 has generally stabilized since the large decrease in tax year 2003. The annual change of -1.6% from tax year 2003 to 2004 is used to forecast future levels of class 13 telecommunication and electric generation property.

Summary of Growth Rates for Each Property Class

Table 10 shows the estimated growth rate for each class of property for tax year 2005 and 2006.

Table 10 Estimated Tax Year 2005 and 2006 Growth Rates			
Class	Description	Estimated Growth Rate	
		TY 2005	TY 2006
1	Net Proceeds of Mines	0.0%	0.0%
2	Gross Proceeds of Mines	0.0%	0.0%
3	Agricultural Land	-0.1%	-0.1%
4	Res./Comm. Real Property	4.0%	4.0%
5	Rural Co-Op/Pollution Control	0.0%	0.0%
6	Livestock	0.0%	0.0%
7	Non-centrally Assessed Utilities	0.0%	0.0%
8	Business Personal Property	3.9%	2.9%
9	Utilities	-0.1%	-0.1%
10	Forest Land	0.0%	0.0%
12	Airlines/Railroads	0.9%	0.9%
13	Telecomm. & Electric Generation	-1.6%	-1.6%

Step 2: Determine the Applicable Tax Rate for Each Class of Property

Property tax rates for each class of property are set by the Legislature and are shown on the left-hand side of Table 11. Three classes of property require consideration of other factors to determine the applicable tax rate to use in revenue estimating: class 3 agricultural land, class 4 residential and commercial, and class 12 railroads and airlines. The applicable tax rate for revenue estimation purposes is also shown in the table. The tax rate variances are briefly explained for these three classes of property under the taxable value section for each tax class.

Table 11 Property Tax Rates						
Property Tax Class	-----Standard Tax Rate-----			-----Applicable Tax Rate-----		
	FY 05	FY 06	FY 07	FY 05	FY 06	FY 07
Class 1 - Net Proceeds	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Class 2 - Gross Proceeds	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Class 3 - Agricultural Land	3.30%	3.22%	3.14%	3.46%	3.37%	3.29%
Class 4 - Residential and Commercial	3.30%	3.22%	3.14%	3.27%	3.19%	3.11%
Class 5 - Pollution Control	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Class 7 - Non-centrally Assessed Utilities	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Class 8 - Business Equipment	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Class 9 - Pipelines and Non-Elec. Generating	12.00%	12.00%	12.00%	12.00%	12.00%	12.00%
Class 10 - Forestland	0.35%	0.35%	0.35%	0.35%	0.35%	0.35%
Class 12 - Airlines and Railroads	Calculate	Calculate	Calculate	3.81%	3.75%	3.69%
Class 13 - Telecom. & Electrical Generation	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%

Step 3: Determine Taxable Value for Each Class of Property

All property except classes 3, 4, and 10¹ have a full market value established January 1 of each year. Classes 3, 4, and 10 have a full reappraisal value established every six years. SB 461 (2003 session) and 15-7-111, MCA, which phases in the reappraisal values for classes 3 and 4 property over six years, must be considered when calculating taxable values for class 3 and 4.

SB 461, as shown in Table 12, in conjunction with the six-year phase-in provisions² of the law, mitigates the effects of reappraisal by increasing the tax-exempt percent for class 4, and decreases the tax rate for classes 3 and 4. This analysis assumes that SB 461 holds classes 3 and 4 existing property taxable values neutral, and that the only change in taxable value is attributable to the normal (step 1) growth rates.

Table 12 SB 461 Tax and Exemption Rates			
Fiscal Year	Class 4 Tax Rate	Class 4 Exemption Percent	
		Residential	Commercial
2003	3.46%	31.00%	13.00%
2004	3.40%	31.00%	13.00%
2005	3.30%	31.40%	13.30%
2006	3.22%	32.00%	13.80%
2007	3.14%	32.60%	14.20%
2008	3.07%	33.20%	14.60%
2009	3.01%	34.00%	15.00%

¹ Class 10 timberland is 0.4% of the total taxable value and has a tax rate of 0.35%. This is so small that no special adjustments are discussed or made for timberland in the revenue estimate.

² The new value is phased in over six years if it is an increase in value. If the new reappraisal value is less than the prior reappraisal value, then the new value is effective immediately.

Taxable Value for Class 1, 2, 5, 7, and 10

There are no statutory changes to class 1, net proceeds of all mines except coal and metal; class 2, gross proceeds from metal mines; class 5 rural co-operatives and pollution control; class 7 non-centrally assessed utilities; and class 10 timberland. As seen in Table 13, since a growth rate of 0% has been estimated for these classes of property, the projected taxable value is held constant at their tax year 2004, or fiscal year 2005 level.

Table 13 Taxable Value - Classes 1, 2, 5, 7, and 10					
Fiscal Year	Class 1	Class 2	Class 5	Class 7	Class 10
A 2005	\$8,032,414	\$10,428,300	\$34,024,275	\$974,316	\$45,074,061
F 2006	\$8,032,414	\$10,428,300	\$34,024,275	\$974,316	\$45,074,061
F 2006	\$8,032,414	\$10,428,300	\$34,024,275	\$974,316	\$45,074,061

Taxable Value for Class 3 (Agricultural Land)

The taxable value of class 3 agricultural land is the combination of the estimated -0.1% growth rate, phasing-in the 2003 reappraisal values, and the reduced tax rate each year. Table 14 shows the combined impacts of the growth rate, the effects of the 2003 reappraisal cycle, and the reduced tax rate on class 3 assessed and taxable values through FY 2007. Although the assessed value of class 3 increases due to phasing-in the increase in value due to reappraisal, the increase is offset by the tax rate reduction under SB 461. As previously explained, the tax rate reduction was designed to hold the taxable value of class 3 property neutral.

Table 14 Taxable Value - Class 3						
Fiscal Year	Assessed Value	% Chg.	Tax Rate	Applicable Tax Rate	Taxable Value	% Chg.
A 2005	\$4,044,106,892	-	3.30%	3.46%	\$139,901,823	
F 2006	\$4,146,599,241	2.53%	3.22%	3.37%	\$139,761,921	-0.10%
F 2007	\$4,248,913,674	2.47%	3.14%	3.29%	\$139,622,159	-0.10%

The applicable tax rates for agricultural land are slightly *higher* than the standard tax rates for class 3 property of 3.30% in FY 2005, 3.22% in FY 2006, and 3.14% in FY 2007. Some property in class 3 is classified as non-qualified agricultural land. This land is valued at the average grade of grazing land and has a tax rate of seven times the standard agricultural land tax rate. This causes the effective tax rate to be higher than the standard rate. The agricultural land tax rate for revenue estimation purposes is 3.46% in FY 2005, 3.37% in FY 2006, and 3.29% in FY 2007.

Taxable Value for Class 4 (Residential and Commercial Real Property)

In conjunction with the current law six-year phase in of the reappraisal value, SB 461 mitigates the effects of reappraisal on class 4 residential and commercial real property. SB 461 uses two adjustments to neutralize the increase in class 4 taxable value: the first adjustment is an increase in the exemption percent for residential and commercial property; the second is a reduction in the tax rate (both adjustments are displayed in Table 12). Since SB 461 mitigates the effects of reappraisal, the only projected change to taxable value is attributable to the estimated 4% growth rate for new construction.

Table 15 shows the net assessed value, the phased-in market value after the homestead and comstead exemptions are applied, the applicable tax rate, the taxable value, and the percent change in taxable value. The percent change in taxable value is equal to the estimated 4% growth rate.

Table 15					
Taxable Value - Class 4					
Fiscal Year	Net Assessed Value (After Exemption)	% Chg.	Applicable Tax Rate	Taxable Value	% Chg.
A 2005	\$32,949,947,401		3.269%	\$1,076,984,542	-
F 2006	\$35,122,732,016	6.6%	3.189%	\$1,120,063,924	4.0%
F 2007	\$37,467,561,306	6.7%	3.109%	\$1,164,866,481	4.0%

The applicable tax rates for class 4 property are 3.27% for FY 2005, 3.19% for FY 2006, and 3.11% for FY 2007. These tax rates are slightly lower than the standard tax rates for class 4 property of 3.30% in FY 2005, 3.22% in FY 2006, and 3.14% in FY 2007. This is because some residential property is included in the property tax assistance (low-income) program, some residential property is included in the extended property tax assistance program provided for under SB 461, golf courses are half the standard class 4 rate, and some commercial property is included in various local option abatement programs. Properties in these programs are subject to a tax rate lower than the standard tax rate, which causes the applicable tax rate to be lower than the standard tax rate.

Taxable Value for Class 8 (Business Equipment)

Class 8 business equipment is projected using the estimated growth rate of 3.9% for *tax year* 2005, and 2.9% for *tax year* 2006. The estimated total taxable value of class 8 is listed in Table 16.

Table 16					
Taxable Value - Class 8					
Fiscal Year	Assessed Value	% Chg.	Tax Rate	Taxable Value	% Chg.
A 2005	\$3,965,949,846	-	3.0%	\$118,978,495	
F 2006	\$4,105,192,195	3.5%	3.0%	\$123,155,766	3.5%
F 2007	\$4,224,242,769	2.9%	3.0%	\$126,727,283	2.9%

Notice in Table 16 that the growth from *fiscal year* 2005 to *fiscal year* 2006 of 3.5% does not match the anticipated *tax year* growth rate of 3.9%. Property value is always established on January 1, of the calendar year. Generally the January 1st value results in property taxes being paid in November of that calendar year, and May of the next calendar year. These payment dates correspond to the following fiscal year. However, in contrast to the other classes of property, a portion of class 8 business equipment owners pay their taxes in the first six months of the calendar year, or one fiscal year earlier.

Under the provisions of 15-16-119, MCA, owners of personal property that is not-liened to real property, such as mobile equipment, pay property taxes 30 days after assessments are mailed. This means that instead of paying taxes in November and May of the following fiscal year, they will pay the tax sometime in the spring of the current fiscal year. As a general rule, approximately 38% of personal property is not-liened to real property. The adjustment in FY 2006 is made by multiplying 62% of personal property by the current year growth rate of 3.9%, while multiplying the remaining 38% of property by the following year growth rate of 2.9%. The formula is: $FY2006\ growth = ((62\% \times 3.9\%) + (38\% \times 2.9\%)) = 3.5\%$.

There is a significant amount of class 8 property located in tax increment districts (TIFs). Although this TIF value is included in the total taxable value of class 8 property, it cannot be included as taxable property for state purposes. When a TIF is established, the increased amounts of taxable value are identified as incremental taxable value, and all property taxes levied on the incremental taxable value are paid to the TIF district, with the exception of the university system 6 mill levy. The total taxable value of class 8, including the TIF incremental taxable value is listed in Table 16. TIF incremental taxable value amounts are discussed and removed from the calculation of state property tax revenue later in the TIF section of this report.

Taxable Value of Class 9 (Utility Property)

Class 9 is the non-electric generation property of electric utilities and the property of centrally assessed pipelines. The results of applying the -0.1% annual growth rate to class 9 property is shown in Table 17.

Table 17					
Taxable Value - Class 9					
<u>Fiscal Year</u>	<u>Assessed Value</u>	<u>% Chg.</u>	<u>Tax Rate</u>	<u>Taxable Value</u>	<u>% Chg.</u>
A 2005	\$1,833,273,533	-	12.0%	\$219,992,824	-
F 2006	\$1,831,440,260	-0.1%	12.0%	\$219,772,831	-0.1%
F 2007	\$1,829,608,820	-0.1%	12.0%	\$219,553,058	-0.1%

Taxable Value of Class 12 (Railroad and Airline Property)

The projected taxable value for class 12 railroad and airline property is based on two factors: an annual growth rate of 0.9%; and the estimated tax rate applied to class 12 property.

The tax rate for class 12 property is a calculated average taxable rate of all non-class 12 commercial and industrial property in the state. The applicable class 12 tax rate is 3.81% for FY 2005. Historically, the class 12 tax rate has decreased every year as the effective tax rates of all other commercial property decreases. Using the estimated assessed and taxable values for commercial and industrial property, the class 12 rate is projected to be 3.75% in FY 2006 and 3.69% in FY 2007.

Table 18					
Taxable Value - Class 12					
<u>Fiscal Year</u>	<u>Assessed Value</u>	<u>% Chg.</u>	<u>Tax Rate</u>	<u>Taxable Value</u>	<u>% Chg.</u>
A 2005	\$1,183,046,155	-	3.81%	\$45,074,061	
F 2006	\$1,193,693,570	0.9%	3.75%	\$44,763,509	-0.7%
F 2007	\$1,204,436,813	0.9%	3.69%	\$44,443,718	-0.7%

Taxable Value for Class 13 (Telecommunication and Electrical Property)

Class 13 is a class of property created by HB 128 and HB 174, both passed by the 1999 legislature. HB 128 moved utility telecommunication property previously classified in class 9 into class 13. HB 174 moved utility electrical generation property that was previously classified in class 9 into class 13. The taxable rate for class 13 property is 6% as opposed to the taxable rate of 12% for class 9 property. Taxable values for class 13 property are based on an annual growth rate of -1.6%. Table 19 shows the estimated taxable value for class 13.

Table 19 Taxable Value - Class 13					
Fiscal Year	Assessed Value	% Chg.	Tax Rate	Taxable Value	% Chg.
A 2005	\$2,008,084,417	-	6.0%	\$120,485,065	
F 2006	\$1,975,955,066	-1.6%	6.0%	\$118,557,304	-1.6%
F 2007	\$1,944,339,785	-1.6%	6.0%	\$116,660,387	-1.6%

Taxable Value Summary

Table 20 summarizes the taxable value for each class of property. The statewide total taxable value for tax year 2004 is \$1,780 million. For revenue estimation, tax year class 8 taxable value is converted to a fiscal year basis. Fiscal year taxable values are projected at \$1.782 million for FY 2005, \$1.826 million for FY 2006, and \$1.872 million for FY 2007. These are annual statewide increases of approximately 2.51% a year.

Table 20 Taxable Value Summary				
Property Class Description	Tax Year 2004	Fiscal 2005	Fiscal 2006	Fiscal 2007
1. Net Proceeds	\$ 8,032,414	\$ 8,032,414	\$ 8,032,414	\$ 8,032,414
2. Gross Proceeds	\$ 10,428,300	10,428,300	10,428,300	10,428,300
3. Agricultural Land	\$ 139,901,823	139,901,823	139,761,921	139,622,159
4. Res./Comm. Real Property	1,076,984,542	1,076,984,542	1,120,063,924	1,164,866,481
5. Rural Co-Op/Poll. Control	34,024,275	34,024,275	34,024,275	34,024,275
7. Non-centrally Assessed Util.	974,316	974,316	974,316	974,316
8. Business Equipment	117,240,984	118,978,495	123,155,766	126,727,283
9. Pipelines, Elec. Trans.	219,992,824	219,992,824	219,772,831	219,553,058
10. Forest Land	6,791,382	6,790,921	6,790,921	6,790,921
12. Airlines/Railroads	45,074,061	45,074,061	44,763,509	44,443,718
13. Telecomm./Elec Generation	120,485,065	120,485,065	118,557,304	116,660,387
Statewide Taxable Value	\$1,779,929,986	\$1,781,667,037	\$1,826,325,481	\$1,872,123,313
Annual Change in Total Value			2.51%	2.51%

Step 3: Calculate the 95 Mill Levy Revenue

The 95 mill levy is levied statewide. However, it cannot be applied directly to the statewide taxable values in Table 20. Two adjustments must be made to statewide taxable values before applying the 95 mills. The adjustments account for the loss in taxable value associated with TIFs, and the addition of taxable value from property receiving local abatements. After accounting for TIFs and local abatements, the 95 mills can be levied. Finally, two deductions are made to the property tax revenue generated by the 95 mills. The first deduction is to account for SB 417 personal property tax reimbursement to local governments (passed by the 1995 legislature). The second deduction is for out-of-district tuition charges under 20-5-324,MCA.

Taxable Value Adjustment 1 - Tax Increment Finance Districts (TIFs)

The taxable values in Table 20 include the incremental taxable value of property in TIFs, which must be removed for the 95 mill revenue estimate. The TIF district, rather than the state, realizes the property tax revenue generated by 95 mills levied to the incremental taxable value of a TIF. There are currently 20 TIF districts in the state. As shown in Table 21, the incremental taxable value of all TIF districts for FY 2005 is \$27,766,903.

Table 21 TIF Incremental Value	
Fiscal Year	Taxable Value
A 2005	\$27,766,903
F 2006	\$27,905,738
F 2007	\$23,270,153

Removing disbanded (expired) districts and one-time decreases, and estimating growth of each district individually, it is anticipated that the average annual growth rate for TIF districts in FY 2006 and FY 2007 will be approximately 0.5%. However, three large TIF districts expire prior to FY 2007, and the incremental value of these districts is removed from the property tax estimate for FY 2007.

Taxable Value Adjustment 2 - Abated Property

Under Montana law, local governments have the authority to reduce the taxable value of property subject to local mill levies. For example, the business equipment for a qualified new business may be subject to a tax rate of 1.5% instead of 3%. However, this abatement does not apply to the 95 mills levied statewide. The local property tax liability will be calculated at the lower, abated tax rate, but the state property tax will be calculated with the normal tax rate.

The summary of statewide total taxable values listed in Table 20 includes the reduced taxable value of property subject to a local abatement. The abated taxable value of this property is the taxable value of the property exempt from local mills, but not exempt from statewide mills. When applying state mills, this abated taxable

Table 22 Abated Taxable Value	
Fiscal Year	Taxable Value
A 2005	\$4,088,317
F 2006	\$4,088,317
F 2007	\$4,088,317

value is added to the statewide total. Shown in Table 22 the amount of abated taxable value for FY 2005 is \$4,088,317. For estimation purposes, the value of the abated property in future years is held at the FY 2005 level.

Deduction 1 - SB 417 Reimbursements

SB 417 (1995 session) reduced the tax rate applied to class 8 property (business equipment) from 9% to 6% over a three-year period, with the first tax rate reduction in 1996. Local governments and school districts are compensated for the loss of property tax revenue associated with SB 417 by retaining part of the 95 mill property tax revenue. So the SB 417 reimbursements are subtracted from the state estimate of the 95 mill property tax revenue. Starting in FY 2000, the reimbursements are phased out for each taxing jurisdiction at 10% of the FY 1999 amount each year. The reimbursement for FY 2000 is 90% of the FY 1999 reimbursement. The FY 2001 reimbursement is 80% of the FY 1999 reimbursement, and so on until the last reimbursement in FY 2008. Taxing jurisdictions that expire do not continue to receive a reimbursement. The SB 417 reimbursement schedule for FY1996 through FY 2009 is listed in Table 23.

Table 23 SB 417 Reimbursement	
Fiscal Year	Amount
1996	\$2,263,486
1997	\$7,881,301
1998	\$12,201,128
1999	\$14,125,466
2000	\$12,712,919
2001	\$11,300,373
2002	\$9,887,826
2003	\$8,439,377
2004	\$7,032,814
2005	\$5,626,250
2006	\$4,185,248
2007	\$2,788,859
2008	\$1,394,430
2009	\$0

Deduction 2 – Out of District Tuition Charges

Under 20-5-324, MCA, the state pays for tuition charges of students who attend a school outside their district if they are placed in a home or institution by a state agency or court. The state's obligation is withheld at the local level from the remittance of the 40 mill levy revenue. It is estimated that the state's obligation is approximately \$370,000 each year.

Calculate State General Fund Property Tax Revenue Generated by 95 Mills

Table 24 on the following page shows the calculation of the general fund revenue from the 95 mill levy. First, the statewide taxable value is adjusted for the TIFs and abated property. Second, the adjusted statewide taxable value is multiplied by 95 mills. Third, SB 417 reimbursements and out-of-district tuition payments retained by local governments are deducted. The forecast is \$166.7 million in FY 2006, and \$172.9 million in FY 2007.

Table 24
General Fund Revenue from 95 Mills

	Fiscal 2005	Fiscal 2006	Fiscal 2007
Unadjusted Statewide Taxable Value	\$ 1,781,667,037	\$ 1,826,325,481	\$ 1,872,123,313
Adjustment for TIF Valuations	(27,766,903)	(27,905,738)	(23,270,153)
Adjustment for Abated Property	4,088,317	4,088,317	4,088,317
Subtotal	\$ 1,757,988,450	\$ 1,802,508,060	\$ 1,852,941,477
Apply 95 Mills	X 0.095	X 0.095	X 0.095
Subtotal	\$ 167,008,903	171,238,266	176,029,440
Less SB417 Reimbursements	(5,626,250)	(4,185,248)	(2,788,859)
Less Out-of-District Tuition	(370,000)	(370,000)	(370,000)
State Revenue from 95 Mills	\$ 161,012,652	\$ 166,683,018	\$ 172,870,581

Calculate the 1.5 Mill Levy Property Tax Revenue

A 1.5 mill is levied on property in five counties where colleges of technology reside (Silver Bow, Cascade, Yellowstone, Missoula, and Lewis and Clark).

Table 25 shows the actual FY 2005 taxable values, along with the FY 2006 and FY 2007 estimated taxable values of the five counties. The taxable value of the five counties represents 35.3% of the statewide taxable value in FY 2005. However, because there are multiple new, or expanding large commercial projects located in these counties, it is expected that these counties will have higher growth rates than the average statewide growth (from Table 20) for the next two years. For estimation purposes, the average growth applied to the 1.5 mill counties is increased 10% over the statewide average for each year, yielding growth rates of 2.76% (2.51% x 1.10%) in FY 2006 and FY 2007.

Table 25
Projected Taxable Value for the 1.5 Mill Levy

County	----- Actual -----	----- Projected -----	
	Fiscal 2005	Fiscal 2006 2.76%	Fiscal 2007 2.76%
Cascade	\$ 109,296,050	\$ 112,309,571	\$ 115,406,181
Lewis and Clark	\$ 88,021,310	\$ 90,448,242	\$ 92,942,089
Missoula	\$ 167,138,567	\$ 171,746,927	\$ 176,482,349
Silver Bow	\$ 48,172,935	\$ 49,501,164	\$ 50,866,014
Yellowstone	\$ 215,714,493	\$ 221,662,193	\$ 227,773,884
Total Taxable Value	\$ 628,343,355	\$ 645,668,096	\$ 663,470,517
Total Statewide Value	\$ 1,781,667,037	\$ 1,826,325,481	\$ 1,872,123,313
Percent of Total	35.3%	35.4%	35.4%

The counties taxable value for the 1.5 mill levy is adjusted by subtracting the TIF districts incremental taxable value and adding the taxable value of abated property, both of which are explained below.

Taxable Value Adjustment 1 - Increment Finance District (TIF) - 1.5 Mill Levy

The valuation of the TIF districts in the five college of technology counties is \$23,650,909 for FY 2005. The FY 2005 taxable value is increased by 0.5% (the estimated average annual growth rate of TIF taxable values for FY 2006 to FY 2007) to project the incremental taxable valuation of the TIF districts in FY 2006 and FY 2007. Prior to FY 2007, multiple TIF districts will expire in the five counties. After these TIF districts expire, the FY 2007 taxable value of the TIF districts is estimated at \$18.7 million.

Table 26 Value of TIFs 1.5 Mill Levy Counties	
Fiscal Year	Taxable Value
2005	\$23,650,909
2006	\$23,769,164
2007	\$18,704,440

Taxable Value Adjustment 2 - Abated Property - 1.5 Mill Levy

The taxable value of abated property in the five 1.5 mill levy counties was \$2,482,838 in FY 2005. For estimation purposes, abated taxable value of the five college of technology counties is held constant at their FY 2005 level of \$2.48 million in FY 2006 and FY 2007.

Table 27 Abated Value 1.5 Mill Levy Counties	
Fiscal Year	Taxable Value
2005	\$2,482,838
2006	\$2,482,838
2007	\$2,482,838

Calculate the General Fund Revenue for the 1.5 Mill Levy

Given the aforementioned adjustments, the property tax revenue generated by the 1.5 mill levy can now be estimated. The first step is to adjust the total taxable value of the five 1.5 mill levy counties for the values of TIFs and abated property. Then apply the 1.5 mill levy to the adjusted taxable values. Table 28 on the following page shows the 1.5 mill levy calculation. The estimated property tax revenue generated by the college of technology 1.5 mill levy is \$910,763 in FY 2005, \$936,573 in FY 2006, and \$970,873 in FY 2007.

Table 28 Property Tax 1.5 Mill Levy General Fund Revenue			
Calculation	FY 2005	FY 2006	FY 2007
Unadjusted Taxable Value	\$ 628,343,355	\$ 645,668,096	\$ 663,470,517
Adjustment for TIF Valuations	(23,650,909)	(23,769,164)	(18,704,440)
Adjustment for Abated Property	2,482,838	2,482,838	2,482,838
Adjusted Taxable Value	\$ 607,175,284	\$ 624,381,771	\$ 647,248,915
Apply the 1.5 Mill Levy	X 0.0015	X 0.0015	X 0.0015
1.5 Mill Levy Revenue	\$ 910,763	\$ 936,573	\$ 970,873

Revenue Estimate – 95 Mill and 1.5 Mill Levy Revenue

Table 29 combines the property tax mill levy revenue from the 95 mill levy with the 1.5 mill levy for a total mill levy revenue estimate of \$161.9 million in FY 2005, \$167.6 million in FY 2006, and \$173.8 million in FY 2007. This is the property tax mill levy revenue portion of the total general fund property tax revenue estimate.

Table 29 Property Tax 95 Mill and 1.5 Mill Levy Revenue Estimate			
Source	FY 2005	FY 2006	FY 2007
95 Mills Levied Statewide	\$161,012,652	\$166,683,018	\$172,870,581
1.5 Mill Levy	\$910,763	\$936,573	\$970,873
State Revenue - 95 and 1.5 Mill Levy	\$161,923,415	\$167,619,591	\$173,841,454

The property tax mill levy revenue estimate will be combined with the non-levy revenue estimate to produce the total property tax general fund revenue estimate. The non-levy revenue estimate is described in the next section.

Forecast Methodology and Projection - Non-Levy Revenue

Non-levy revenue is revenue that gets paid as part of property taxes, but is not a direct levy on the ad-valorem value of property. These non-levy sources of revenue are taxes paid on coal gross proceeds, federal forest reserve payments, and an all other category.

Generally, non-levy revenue is distributed to taxing jurisdictions in which the revenue is collected. The share of the non-levy revenue for a taxing jurisdiction is based on the number of mills levied by that taxing jurisdiction, in relation to the total number of mills levied by all affected taxing jurisdictions. For example, if the total mill levy in a taxing jurisdiction was 350 mills, then the state general fund would receive 27.1% (95/350) of the non-levy revenue.

The non-levy revenue sources are categorized and explained in the following order: 1) coal gross proceeds, 2) federal forest reserves, and 3) all other.

Coal Gross Proceeds

Coal gross proceeds are distributed as non-levy revenue based on mill levies, with one significant nuance. In calculating the distribution of coal gross proceeds, the mills are based on tax year 1989 mill levies. This is significant because in 1989 the total state mills levied was 45, compared to the current total of 95 mills.

In tax year 1989, the average total mill levy in areas where coal was mined totaled 107.91 mills. The state share is calculated to be 41.7% (45/107.91). Based on estimated total coal gross proceeds (calculated under the coal severance tax revenue estimate), and tax year 1989 mill levies, the state portion of non-levy revenue from coal gross proceeds is estimated to be approximately \$4.692 million in FY 2005, \$4.402 million in FY 2006, and \$4.394 million in FY 2007. Table 30 shows the estimated total amount of coal gross proceeds, and the 45 mill allocation for the general fund.

Table 30			
General Fund Non-Levy Revenue			
Coal Gross Proceeds			
Fiscal Year	Total Proceeds	45 Mill Share	45 Mill Revenue
A 2004	\$11,057,326	41.7%	\$4,610,905
F 2005	\$11,253,028	41.7%	\$4,692,513
F 2006	\$10,555,574	41.7%	\$4,401,675
F 2007	\$10,536,766	41.7%	\$4,393,831

Federal Forest Reserves

Federal forest reserves are a non-levy revenue source allocated to the 22 and 33 statewide mill levies. These are payments made by the federal government to counties where revenues were generated on national forests. By state law, the money must be allocated two-thirds to the county road fund, and the remaining third to be distributed to countywide school levies. This would include county mills levied for retirement and transportation, along with the 55 mills levied statewide. In FY 2004, it is estimated that

the 55 mills represented 59.5% of the total countywide school levies for counties that receive federal forest funds. An estimate of the amount of federal forest reserves allocated to the 55 mills is made by applying 19.83% ($59.5\% \times 33.33\% = 19.83\%$) to the total forest reserve payment.

The federal forest reserve payment was \$11.564 million in FY 2004. Federal law requires that total payments be adjusted annually by 50% of the consumer price index for rural areas. This adjustment is estimated to be 0.8%. The 55 mill share declines each year because the 55 mills are fixed, but other countywide education mills are allowed to increase. It is assumed that the other countywide education mills will increase 2.2%, the rate of inflation. Table 31 shows the forecast revenue for FY 2004 through FY 2007.

Table 31 General Fund Non-Levy Revenue Federal Forest Reserves				
Fiscal Year	Total Payment	% Chg.	55 Mill Share	55 Mill Revenue
F 2004	\$11,564,431		19.83%	\$2,292,701
F 2005	\$11,683,927		19.40%	\$2,266,528
F 2006	\$11,777,398	0.80%	18.98%	\$2,235,480
F 2007	\$11,871,618	0.80%	18.57%	\$2,204,857

All Other Non-Levy Revenue Category

The category all other non-levy revenue consists of a multitude of revenue sources, such as penalties and interest paid on late property tax payments; BLM grazing payments; federal payments in lieu of tax (PILT); county investment earnings; and other miscellaneous sources. The total state share of revenue from these sources is expected to be \$1,550,000 for FY 2005 to FY 2007.

Centrally Assessed Protest Property Taxes

SB 294 (2003 session) required the counties to send the 95 mill levy portion, and the 6 mill levy portion of protested property tax payments made by centrally-assessed companies to the state. As of fiscal year-end 2004, it was estimated that the counties still needed to remit about \$112,000 to the state, which would come in as FY 2005 revenue. It is estimated that approximately \$490,000 will be refunded to companies, which have resolved some of the prior year protests in FY 2005. Thus, the FY 2005 impact of the centrally assessed protested taxes is -\$378,000. Of the -\$378,000, the general fund portion is -\$355,545, and the remaining -\$22,455 impacts is to the state special revenue 6 mill levy account.

Total Property Tax Revenue Estimate

The combined mill levy, and non-levy revenue property tax estimate, adjusted for protested property tax payments and refunds, is shown in Table 32. Property tax revenue is estimated at \$170.1 million in FY 2005, \$175.8 million in FY 2006, and \$182.0 million in FY 2007.

Table 32 Summary of General Fund Property Tax Revenue			
	FY 2005	FY 2006	FY 2007
Property Tax Mill Levy	\$161,923,415	\$167,619,591	\$173,841,454
Non-Levy Revenue:			
Coal Gross Proceeds	4,692,513	4,401,675	4,393,831
Federal Forest Reserves	2,266,528	2,235,480	2,204,857
All Other	1,550,000	1,550,000	1,550,000
Subtotal Non-Levy Revenue	\$ 8,509,041	\$ 8,187,155	\$ 8,148,688
Protested Property Taxes	\$ (355,545)		
Total Property Tax Revenue	\$170,076,911	\$175,806,746	\$181,990,142

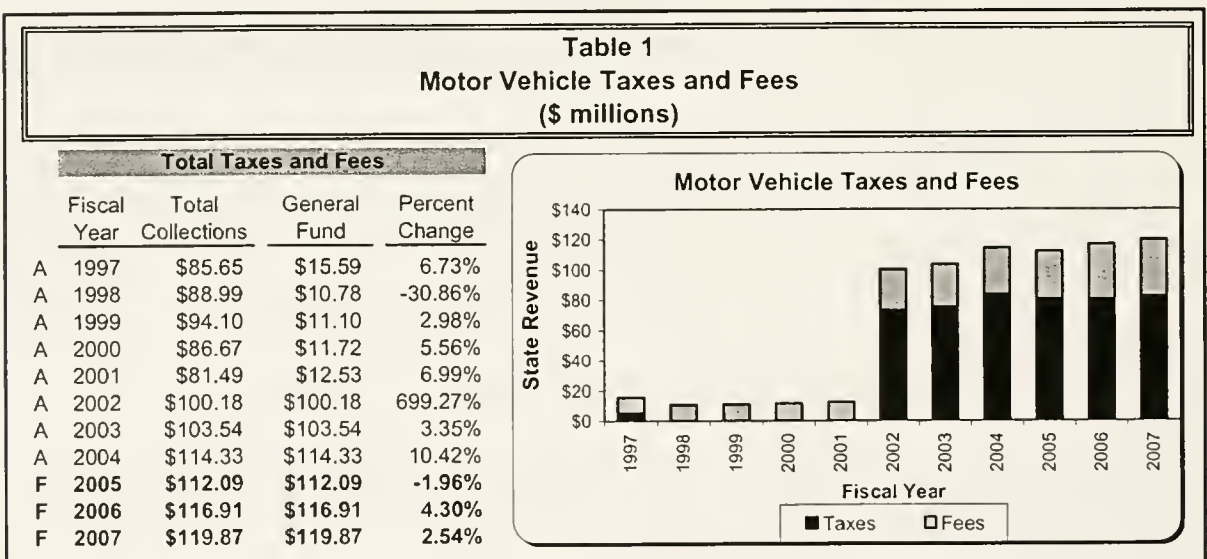
MOTOR VEHICLE TAXES AND FEES

Revenue Description

Titles 61 and 23, MCA, provide for multiple registration fees and fees in lieu of taxes on motor vehicles. Motor vehicles including light vehicles, heavy vehicles weighing more than 1 ton, motor homes, trailers, travel trailers, watercraft, motorcycles, snowmobiles, campers, and off-highway vehicles are charged registration and titling fees, along with fees in lieu of tax based on one or a combination of the following criteria: age, weight, size, or vehicle type.

Historical and Projected Revenue

Table 1 shows actual and projected total tax collections and general fund revenue from motor vehicle taxes and fees for FY 1994 to FY 2007.



The large fluctuations in revenue are mostly attributable to legislative changes. Recent legislation has significantly affected motor vehicle taxes and fees since FY 2000. The following is not a comprehensive list of legislation that has affected motor vehicle taxes and fees; it only includes the bills that had significant fiscal impacts.

SB 260 (1999 session) reduced the ad valorem tax on light vehicles from 2% to 1.4% beginning January 1, 2000. This explains the decrease in vehicle taxes in FY 2000 and FY 2001.

HB 540 (1999 session) and HB 4 (2000 special session) eliminated the ad valorem tax and the 1.5% "new car" sales tax beginning January 1, 2001, and replaced these two ad valorem taxes with a three-tier flat fee based on the age of the vehicle. The

annual revenue from the three-tier flat fee is less than revenue from the two ad valorem taxes.

HB 247 (2001 session) reduced the fee in lieu of tax on heavy vehicles by 50% over a three-year period beginning January 1, 2003. HB 247 is further analyzed and discussed later in the report since its impacts carry into future fiscal years.

HB 124 (2001 session) distributed vehicle taxes to the state general fund beginning in FY 2002. Prior to FY 2002 the fees in lieu of taxes on motor vehicles were distributed to nine separate state revenue accounts. The state general fund did not receive revenue from vehicle taxes from FY 1998 through FY 2001. HB 124 also changed the distribution of miscellaneous motor vehicle fees. Fees retained by local governments and state agencies prior to FY 2002, are now deposited in the state general fund, with a few exceptions. This change in the distribution of vehicle fees explains the general fund increase of 699% in FY 2002.

As Table 1 illustrates, motor vehicle revenue increased 10.42% in FY 2004, and is anticipated to decrease 1.96% in FY 2005, and then show moderate growth in FY 2006 and FY 2007. Projected fluctuations in revenue are mostly the result of legislation passed in the 2003 session: HB559, permanent vehicle registration; SB 118, new license plate issue; SB 336, Fish, Wildlife & Parks \$4 recreation-park fee; and SB 401, renewal notice for licenses. The impact of these bills is discussed in the methodology section.

Combining Vehicle Taxes and Fees

In the past, revenue estimates were provided for motor vehicle taxes and fees separately. However, recent legislation and accounting practices have effectively removed the distinction between vehicle taxes and fees. Although this revenue estimate combines taxes and fees, Table 2 shows historical and projected fees and taxes separately, listed in the prior classifications.

Table 2 Motor Vehicle Taxes and Fees (\$ millions)									
Fiscal Year	Motor Vehicle Taxes			Motor Vehicle Fees			Total Taxes and Fees		
	Total Collections	General Fund	Percent Change	Total Collections	General Fund	Percent Change	Total Collections	General Fund	Percent Change
A 1997	\$75.33	\$5.27	9.74%	\$10.32	\$10.32	5.25%	\$85.65	\$15.59	6.73%
A 1998	\$78.21	\$0.00	N.A.	\$10.78	\$10.78	4.49%	\$88.99	\$10.78	-30.86%
A 1999	\$83.01	\$0.00	N.A.	\$11.10	\$11.10	2.98%	\$94.10	\$11.10	2.98%
A 2000	\$74.95	\$0.00	N.A.	\$11.72	\$11.72	5.56%	\$86.67	\$11.72	5.56%
A 2001	\$68.95	\$0.00	N.A.	\$12.53	\$12.53	6.99%	\$81.49	\$12.53	6.99%
A 2002	\$73.13	\$73.13	N.A.	\$27.05	\$27.05	115.84%	\$100.18	\$100.18	699.27%
A 2003	\$75.19	\$75.19	2.81%	\$28.35	\$28.35	4.80%	\$103.54	\$103.54	3.35%
A 2004	\$83.61	\$83.61	11.20%	\$30.72	\$30.72	8.37%	\$114.33	\$114.33	10.42%
F 2005	\$80.36	\$80.36	-3.88%	\$31.73	\$31.73	3.26%	\$112.09	\$112.09	-1.96%
F 2006	\$80.14	\$80.14	-0.27%	\$36.77	\$36.77	15.89%	\$116.91	\$116.91	4.30%
F 2007	\$82.05	\$82.05	2.38%	\$37.82	\$37.82	2.87%	\$119.87	\$119.87	2.54%

Background

There are numerous vehicle types that pay motor vehicle taxes: light vehicles, watercraft, snowmobiles, motorcycles and quadracycles, off-highway vehicles, travel trailers, trailers, heavy vehicles, motor homes, mobile homes, manufactured dwellings, and special mobile vehicles.

For purposes of this analysis, motor vehicle types can be separated into four major categories:

- 1) *Heavy Vehicles*, which are vehicles that weight more than one ton.
- 2) *Light vehicles*, which are the cars, trucks, and SUVs used as basic commuter transportation.
- 3) Vehicles required to *permanently register*, other than light and heavy vehicles, which includes watercraft, snowmobiles, motorcycles and quadracycles, off-highway vehicles, travel trailers, and trailers.
- 4) Vehicles *not required to permanently register*, other than light and heavy vehicles, which includes motor homes, mobile homes, manufactured dwellings, and special mobile vehicles.

With approximately one million registrations each year, light vehicles currently account for over 75% of all vehicle registrations. Depending on the vehicle type, along with other criteria, a vehicle will pay multiple fees and taxes. For instance, a typical light vehicle (car, truck, SUV) will pay between four and ten taxes/fees. Each motor vehicle type will pay different taxes/fees than another vehicle type, but in most cases will pay a tax or fee also paid by other vehicle types. For instance, nearly all vehicle types are required to pay a \$0.25 senior citizens transportation fee; and all vehicles will pay title fees when title work is required. However, not all vehicles of the same type will pay the same taxes or fees because many taxes and fees are based on multiple criteria such as age, weight, length, use, or even who owns the vehicle.

Table 3 illustrates the overlap and differences in taxes/fees that various types of vehicles pay. Table 3 is for illustration purposes only, and does not include all fees that are assessed for each vehicle type. For example, Table 3 does not include any county taxes/fees; non-general fund revenue taxes/fees like GVW fees, technology fees, safety fees; or other fees that could apply like personalized plate fees.

As Table 3 shows, many types of vehicles pay the same tax/fee, while vehicles of the same type can pay different taxes/fees, or the same tax/fee but differing amounts depending on the vehicles age, weight, length, or use.

Table 3
Illustration of Taxes and Fees Paid on Select Vehicles Tax Year 2004
General Fund Fees/Taxes Only¹

Tax or Fee	Light Vehicles		Heavy Vehicles	Trailer ¹		Travel Trailer	Mobile Home	Motor-cycle	Off Highway	Snow-mobile	WaterCraft	
	Ex. 1	Ex. 2 (new)		Ex. 1	Ex. 2						Ex. 1	Ex. 2
Veterans Services	0.50	0.50	0.50	0.50	0.50	0.50		0.50				
Sr. Citizens Transportation	0.25	0.25	0.25	0.25	0.25			0.25				
FWP Park Fee (optional)		4.00										
Light Registration Fee ²	13.75	18.75	18.75									
Light Registration Flat ²	6.00	195.00										
State Lien Title Fee		4.00					4.00					
Light Title (New Junk Fee)		2.00										
New Plate Issue		5.00										
Truck Flat ³			66.00									
Highway Patrol Pension				1.25	1.25			1.25				
Trailers Flat ²				25.00	65.00							
Trailer Registration ²				8.25	16.25							
Travel Flat ²						65.00						
RV Registration						3.50						
RV Trailer Fee						11.75						
Single Move Permit							5.00					
Motorcycle One-time								20.00				
Motorcycle Registration								9.75				
Off Highway Flat									20.00			
Off Highway Extra									2.00			
Off Highway Registration									9.00			
Snowmobile Flat ²										20.00		
Snowmobile Registration										6.50		
Watercraft Flat ²											25.00	140.00
Boat ID Number											3.50	3.50
Total State Tax¹	\$20.50	\$229.50	\$85.50	\$35.25	\$83.25	\$80.75	\$9.00	\$31.75	\$31.00	\$26.50	\$28.50	\$143.50

¹Does not include all fees that could be paid. For example county taxes/fees, non-general fund revenue like GYW fees - technology fees - safety fees, or other fees that could apply.

²Fee or tax is dependent upon vehicle length, weight, age, use, or ownership.

³Average fee.

Forecast Methodology and Projection Calculation

A revenue estimation model was developed for motor vehicle taxes and fees. Within this model each of the 175 motor vehicle taxes/fees is projected individually and then summed for total revenue. There are four basic steps in the model:

1. The number of transactions for each tax/fee are estimated by calendar year;
2. The appropriate rate is determined for each tax/fee by calendar year;
3. The number of transactions per tax/fee are multiplied by the tax/fee rate for that transaction to obtain total revenue; and
4. Calendar year revenue is converted to fiscal year revenue.

The explanation of the steps is in general terms to convey the theory behind the model. It is not possible to explain within the time or space available, each variable or assumption when there are so many taxes/fees, vehicle types, and law changes.

Step 1: Determine the Number of Transactions for each Tax/Fee

Transaction refers to the number of times each tax/fee is paid. There are four steps to determining the number of transactions for each tax/fee: (1) establish a matrix of taxes/fees by vehicle type; (2) determine the number of transactions which will occur for each tax/fee before the 2003 session law changes; (3) adjust the transactions to reflect the law changes, which includes determining the transfer rate by vehicle type; and (4) determine the impact of the law changes.

Vehicle Fee Matrix

A matrix is established which identifies all vehicle types and every tax/fee that each vehicle type pays. The matrix resembles the illustration in Table 3 that shows a select group of taxes/fees paid by select vehicle types.

Number of Transactions Before 2003 Law Changes

The number of transactions for each tax/fee for calendar year 2003 by vehicle type is determined from the Department of Justice motor vehicle database. Then a growth rate is estimated and applied for each vehicle type for calendar year 2004 through calendar year 2007.

Using the motor vehicle databases for each calendar year, the average annual growth rate from calendar year 2001 through calendar year 2003 for each type of vehicle was determined. The average annual growth rate was then compared with collections through FY 2004 and adjusted to equal the FY 2004 revenue.

For calendar years 2005, 2006, and 2007, national and local economic indicators were compared to recent vehicle growth in Montana. Montana vehicle transactions growth of 5.3% in calendar year 2003 outpaced all national and local economic indicators such as inflation, wage and salary growth, etc. Therefore, Global Insight's national forecasts of 'unit sales of new automobiles' and 'stock of registered light motor vehicles' are used as a baseline to predict growth for all vehicle types.

Figure 1 graphically displays actual and projected Montana transactions, and national new light vehicle sale trends from calendar year 2002 through 2007.

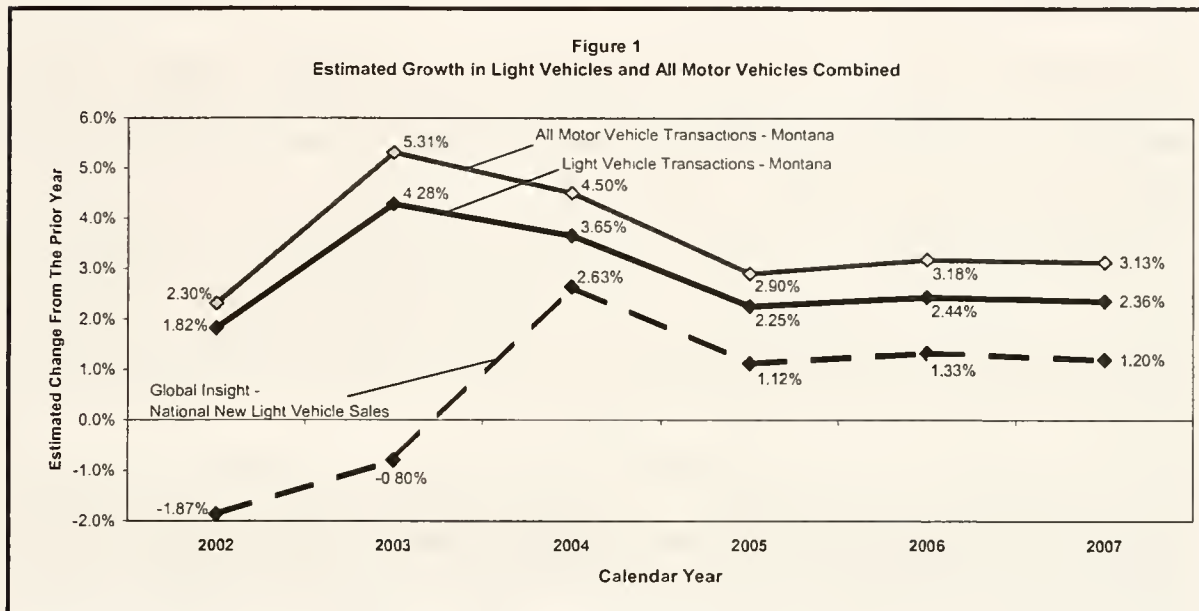


Table 4 shows estimated growth rates and the percent change in growth for Global Insight's national new light vehicle sales and national light vehicle registered stock series, estimated Montana light vehicle transactions, and all motor vehicle types transactions combined in Montana for calendar years 2004 through 2007.

Global Insight's national forecast anticipates growth in new car sales to decrease from 2.63% in calendar year 2004 to 1.12% in 2005, or to slow by 57.5%. Global Insight's national forecast anticipates growth to remain almost constant in 2006 and 2007 with estimated rates of 1.33% and 1.20% respectively. These figures are shown in the top left of Table 4.

Table 4 Estimated Motor Vehicle Growth				
Global Insight - National				
Calendar Year	New Light Vehicle Sales		Registered Light Veh. Stock	
	Growth	% Change	Growth	% Change
2004	2.63%	-	1.51%	-
2005	1.12%	-57.5%	1.60%	6.4%
2006	1.33%	18.7%	1.65%	2.7%
2007	1.20%	-10.0%	1.59%	-3.4%
Montana				
Calendar Year	Light Vehicle Transactions		All Vehicle Transactions	
	Growth	% Change	Growth	% Change
2004	3.65%	-	4.50%	-
2005	2.25%	-38.3%	2.90%	-35.5%
2006	2.44%	8.1%	3.18%	9.6%
2007	2.36%	-3.1%	3.13%	-1.7%

The bottom portion of Table 4 shows the projected growth in transactions for light vehicles and all vehicles being recorded in the motor vehicle database. As Figure 1 shows, projected growth rates closely follow Global Insight's national trend in new light vehicle sales. Montana vehicle transactions in the past, however, have not seen the extreme highs or lows that were observed at the national level. In addition, as shown in Figure 1, the actual growth rate in Montana transactions has been consistently higher than the national trend. Hence, as Table 4 and Figure 1 show, the projected growth trends in Montana vehicle stock has been leveled slightly for calendar years 2004 through 2007, but is projected to remain at a constant level above Global Insight's national trend.

Notice that the growth rate for all motor vehicles, including light vehicles, is higher than the growth rate of light vehicles. The growth rate in other vehicles is higher because some vehicle types, such as motorcycles, have an average growth rate of three or four times that of light vehicles.

The model projects growth rates for each vehicle type separately, by adjusting the actual annual average growth rate by the percent change in the growth shown in Table 4. However, with federal accelerated depreciation sun-setting January 1, 2005, it is expected that heavy vehicle purchases will slow. For purposes of this analysis, heavy vehicles are held constant.

For vehicles other than heavy and light vehicles, the actual average annual growth rate is adjusted for future years by the percent change estimated for all vehicles. The estimated percent change for all vehicles is shown on the bottom right of Table 4, and is estimated at -35.5% in calendar 2005, 9.6% in calendar 2006, and -1.7% for calendar 2007. For example, growth for mobile homes is estimated at 3.42% in calendar year 2004; 2.21% in calendar year 2005 $((3.42\% \times (-35.5\% + 100\%))$; 2.42% in calendar year 2006 $((2.21\% \times (9.6\% + 100\%))$; and 2.38% in calendar year 2007 $((2.42\% \times (-1.7\% + 100\%))$. This methodology is applied to all vehicle types.

Adjust the transaction for 2003 Legislation

HB 559 (2003 session) requires permanent registration of watercraft, snowmobiles, motorcycles and quadracycles (except those with specialty license plates), off-highway vehicles, travel trailers, and trailers. Beginning January 1, 2005, permanently registered vehicles under HB 559 will only register and pay taxes and fees each time they are registered (new purchase or transfer), or approximately once every four or five years. The estimated number of transactions is adjusted for the changes due to HB 559.

Many taxes/fees under HB 559 are now one-time fees that also are payable upon transfer of ownership. Instead of using motor vehicle counts adjusted for growth, these taxes/fees must be estimated based on new purchases and ownership transfers. Keying on the \$5.00 fee paid for title work in the motor vehicle database

as an indicator of new vehicle purchases or ownership transfers, and assuming that 92% of title work is for ownership transfers, transfer rates are projected for each vehicle type, including adjustments for anticipated growth for each vehicle type.

Transfer rates are higher than natural growth rates because these rates include new vehicles, along with used vehicles sold or transferred to new owners. Observed transfer rates are on average higher than 20%; which means approximately one in five vehicles registered each year is either a new purchase, or was transferred to a new owner. Transfer rates, like growth rates, vary among vehicle types and are estimated separately.

Table 5 shows estimated vehicle transactions without the effects HB 559, and estimated transactions under HB 559. In the table, a transaction is representative of each vehicle record in the DOJ database; a record occurs in the database when taxes/fees are paid, which would include when a vehicle is registered, changes ownership, or some other title work was done and a tax/fee was paid. As shown on the right-hand side of Table 5, beginning in calendar year 2005 when permanent registration is required for multiple vehicle types under HB 559, the number of vehicle transactions is projected to decrease by nearly 20%.

Table 5 HB 559 Estimated Impacts Vehicle Transactions (millions)								
Calendar Year	Transactions Without HB 559				Transactions With HB 559			
	Light Vehicle	Other Vehicles	Total	Change	Light Vehicle	Other Vehicles	Total	Change
2003	1.032	0.460	1.492		1.032	0.460	1.492	
2004	1.069	0.490	1.559	4.50%	1.069	0.490	1.559	4.50%
2005	1.093	0.511	1.604	2.90%	1.093	0.167	1.260	-19.18%
2006	1.120	0.535	1.655	3.18%	1.120	0.169	1.289	2.29%
2007	1.147	0.561	1.707	3.13%	1.147	0.171	1.318	2.23%

Step 2: Updated Tax/Fee Rates

The legislature changed many of the tax/fee rates and what types of vehicles pay each tax/fee during the last sessions.

HB 247 (2001 session) reduced the fee in lieu of tax on heavy vehicles by 50% over a three-year period beginning January 1, 2003. HB 247 impacts are projected using anticipated vehicle counts multiplied by an estimated average tax rate. Estimated impacts are shown in Table 6.

Table 6
Estimated HB247 (2001 Session) Revenue Impact

Fiscal Year	Prior to HB247				HB247 Implemented				Revenue Change
	Number of Vehicles	Average Tax Rate	Heavy Vehicle Revenue		Number of Vehicles	Average Tax Rate	Heavy Vehicle Revenue		
2003	37,380	x \$78.12	=	\$2,920,228	37,380	x \$66.03	=	\$2,468,201	(\$452,026)
2004	37,380	x \$78.12	=	\$2,920,228	37,380	x \$55.43	=	\$2,071,882	(\$848,345)
2005	37,380	x \$78.12	=	\$2,920,228	37,380	x \$46.53	=	\$1,739,200	(\$1,181,028)
2006	37,380	x \$78.12	=	\$2,920,228	37,380	x \$39.06	=	\$1,459,937	(\$1,460,291)
2007	37,380	x \$78.12	=	\$2,920,228	37,380	x \$39.06	=	\$1,459,937	(\$1,460,291)

HB 559 (2003 session) increases taxes on light vehicles and replaces the annual fee in lieu of tax on watercraft, snowmobiles, motorcycles and quadracycles (except those with specialty licenses plates), off-highway vehicles, travel trailers, and trailers with a one-time flat fee. The one-time flat fee assessed in tax year 2004 will generally, but not always, be higher than the annual fee it replaces; the one-time fee then doubles in calendar year 2005.

Beginning January 1, 2004, all vehicle types that are required to permanently register will pay the new one-time fee when registering in calendar year 2004: in subsequent years, the fee will only be paid on new vehicle registrations or upon transfer of ownership.

This bill also eliminates the registration fee and fee in lieu of tax for campers, motorized pontoons, and motorized rubber rafts.

In addition, HB 559 provides for a \$1.25 fee for the Highway Patrol Pension Trust Fund that replaces the permanent registration fee of \$2.00 for trailers, motorcycles, and quadracycles. This fee is currently recorded in the state accounting system (SABHRS) under general fund motor vehicle taxes and is included under that heading in Table 2. The funds are then transferred to the Highway Patrol pension fund per 15-1-122, MCA.

SB 118 (2003 session) increases the fee for newly issued plates from \$2 to \$5 effective January 1, 2004. SB 118 also delays the issuance of new replacement plates for all vehicles that are required to have license plates from January 1, 2004 to January 1, 2006.

SB 118 impacts are affected by permanent registrations under HB 559. By requiring permanent registration for multiple vehicle types, HB 559 will reduce the number of vehicles being issued new plates when all registered vehicles are scheduled to receive new plates in FY 2006 and FY 2007. Permanently registered vehicles not issued replacement plates in FY 2006 or FY 2007 will receive replacement plates in future years when ownership of the vehicle is transferred. Approximately \$850,000 of new issue plate fees will be moved into future years due to permanent registration under HB 559.

SB 336 (2003 session) assessed a new \$4.00 registration fee on all vehicles for state parks and fishing access sites, replacing day use fees for Montana residents. A registrant may opt-out of this fee if they certify that they do not use state parks or fishing access sites. Revenue from the new fee is projected to be \$1.2 million in FY 2004, and \$2.8 million in FY 2005 and beyond. This fee currently is deposited in a Department of Fish Wildlife and Parks (FWP) account on the state accounting system, SABHRS. Beginning in FY 2006, revenue from this fee will be deposited in the general fund, and then transferred to FWP via fund transfer in accordance with 15-1-122, MCA. Estimated revenue of \$2.8 million from this fee is included in the revenue estimate for FY 2006 and FY 2007. This fee is included under the fee heading in Table 2, explaining the increase in FY 2006.

SB 401 (2003 session) provides for a new registration fee of \$0.50 on all vehicle types except for snowmobiles, off-highway vehicles, watercraft, trailers and semi-trailers registered in other jurisdictions and registered through a proportional registration agreement, and vehicles bearing ex-prisoner of war license plates. Revenue from the new registration fee is estimated at \$400,000 in FY 2004, \$620,000 in FY 2005, \$631,000 in FY 2006, and \$645,000 in FY 2007. This fee is currently recorded in SABHRS as a motor vehicle tax, and is included under that heading in Table 2.

Table 7 shows the major changes in taxes/fees. Table 7 is not a comprehensive list of changes, and only includes changes to taxes/fees that have a significant financial impact to the general fund.

Table 7 Major Changes in General Fund Vehicle Taxes/Fees (Dollars)				
Taxes/Fees	CY2003	CY2004	CY2005 +	Short Description
Truck Flat	66.03*	55.43*	46.53*	HB247 - CY2006 fully implemented average is \$39.06
State Lien Title Fee	4.00	5.00	5.00	HB538
Light Title (New Junk Fee)	2.00	5.00	5.00	HB538 - Only on new light vehicles
Light Registration- Weight <2,850 lbs	13.75	13.75	17.00	HB559
Light Registration- Weight >2,850 lbs	18.75	18.75	22.00	HB559
Motorcycle Flat (now 1-time)	26.00*	20.00	40.00	HB559 - Permanent Reg. - from age & engine size to a flat fee
Highway Patrol Pension		1.25	1.25	HB559 - New in 2004 paid by motorcycles and trailers
Motorcycle Registration	9.75	9.75	11.25	HB559 - Permanent Registration
Trailers Flat <6,000 lbs	15.75*	25.00	50.00	HB559 - Permanent Registration - prior based on age & weight
Trailers Flat >6,000 lbs	15.75*	65.00	135.00	HB559 - Permanent Registration - prior based on age & weight
RV Registration	3.50	3.50	9.75	HB559 - Permanent Registration
Off Highway Flat	9 or 19	20.00	40.00	HB559 - Permanent Registration - prior based on age
Off Highway Registration	9.00	9.00	19.25	HB559 - Permanent Registration
Watercraft Flat up to 16 ft	24.25*	25.00	50.00	HB559 - Permanent Registration - prior based on age & length
Watercraft Flat 16 to 19 ft	24.25*	55.00	110.00	HB559 - Permanent Registration - prior based on age & length
Watercraft Flat over 19 ft	24.25*	140.00	280.00	HB559 - Permanent Registration - prior based on age & length
Boat ID Number	3.50	3.50	15.50	HB559 - Permanent Registration
Snowmobile Flat	15 or 22	20.00	40.00	HB559 - Permanent Registration - prior based on age
Snowmobile Registration	6.50	6.50	20.50	HB559 - Permanent Registration
New Plate Issue	2.00	5.00	5.00	SB118
FWP Park Fee (optional)		4.00	4.00	SB336 - New in 2004
Veterans Services		0.50	0.50	SB401 - New in 2004

*Average tax or fee listed - tax or fee based on multiple criteria

Step 3: Multiply the Number of Transaction by the Appropriate Tax/Fee Rate

The estimated number of transactions for each tax/fee is multiplied by the updated tax/fee rates for each year. The model then adds the amount of revenue received from each of the 175 motor vehicle taxes/fees, and then identifies general fund revenue for each calendar year.

Step 4: Convert Calendar Year Revenue to Fiscal Year Revenue

The model uses calendar year information from the Department of Justice motor vehicle database; and the law changes are calculated on a calendar year basis. Estimated calendar year revenue is split into fiscal years based on registration dates of motor vehicles recorded in the database, and revenue collections recorded in the state accounting system.

Generally, 60% of motor vehicle payments are received by the state in the second half of the fiscal year (January to June). A 40/60% apportionment is used to distribute most vehicle tax and fee collections; revenue received in a fiscal year is estimated as 40% of the prior calendar year's revenue and 60% of current calendar year's revenue. For instance, FY 2004 revenue is comprised of 40% calendar year 2003 revenue and 60% calendar year 2004 revenue.

However, some exceptions do exist and adjustments are made within the model. The following vehicle types are adjusted using a different ratio when moving from a calendar year to a fiscal year basis:

- Heavy Vehicles. Approximately 89% of heavy vehicle registrations and associated tax collections occur between January and June. A ratio of 11% prior calendar year to 89% current calendar year is used to estimate fiscal year revenue.
- Trailers, Travel Trailers, and Motor Homes. Approximately 70% of trailer, travel trailer, and motor home registrations and the associated tax collections occur between January and June. A ratio of 30% prior calendar year to 70% current calendar year is used to estimate fiscal year revenue.
- Boats, Snowmobiles, and Off-Highway Vehicles. Approximately 70% of boat, snowmobile, and off-highway registrations and the associated tax collections occur between January and June. A ratio of 30% prior calendar year to 70% current calendar year is used to estimate fiscal year revenue.

Summary of Methodology - Example

Table 8 is a basic example of how each fee would be calculated. The example shows how the off-highway vehicle (OHV) registration fee is estimated.

1. A baseline number of transactions is projected using actual calendar 2003 counts of 30,080 and anticipated growth. Then the number of transactions is adjusted based on legislative changes. Beginning in calendar 2005, HB 559 requires permanent registration of OHVs. As Table 8 shows, this is estimated to decrease the number of transactions by one third in calendar 2005. The approximately 11,600 transactions represent new vehicle registrations and ownership transfers.
2. The tax/fee rate is updated due to legislative changes. Beginning in calendar 2005, HB 559 increases the OHV registration fee from \$9.00 to \$19.25.
3. The adjusted number of transactions is multiplied by the updated fee. For example, in calendar 2005, 11,599 is multiplied by \$19.25, yielding \$223,289.
4. Last, calendar year amounts are converted to fiscal years. Approximately 70% of off-highway registrations and the associated tax collections occur between January and June. A ratio of 30% prior calendar year to 70% current calendar year is used to estimate fiscal year revenue. With the example in Table 8, for FY 2004 the calculation is $((\$270,720 \times 30\%) + (\$309,096 \times 70\%)) = \$297,583$.

Table 8 Summary Calculation - Example Off-Highway Vehicle (OHV) Registration Fee					
	Calendar 2003	Calendar 2004	Calendar 2005	Calendar 2006	Calendar 2007
Step 1: Baseline # of Transactions	30,080	34,344	36,960	40,132	43,469
Step 1A: Transactions Adjusted for Legislation	30,080	34,344	11,599	11,672	11,749
Step 2: Tax/Fee Adjusted Rate	\$9.00	\$9.00	\$19.25	\$19.25	\$19.25
Step 3: Multiply Transactions by Rate	\$270,720	\$309,096	\$223,289	\$224,695	\$226,174
		Fiscal 2004	Fiscal 2005	Fiscal 2006	Fiscal 2007
Step 4: Convert Revenue to Fiscal Year ¹		\$297,583	\$249,031	\$224,273	\$225,730

¹(30% Prior Calendar Year and 70% Current Calendar Year)

General Fund Revenue

General fund motor vehicle revenue is estimated at \$112.09 million in FY 2005, \$116.91 in FY 2006, and \$119.87 million in FY 2007.

CORPORATION LICENSE TAX

Revenue Description

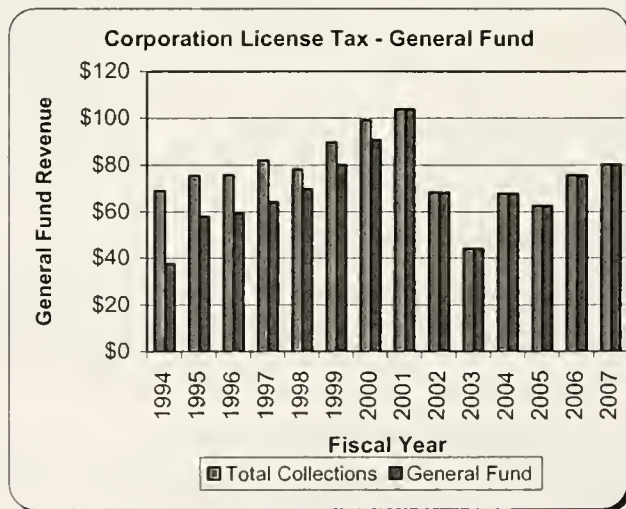
The Corporation License Tax is a tax on corporate income apportioned to Montana. The tax is levied at a flat rate of 6.75% of net income; however corporations making a "water's edge" election are taxed at 7%. Beginning in FY 2001, revenues are deposited 100% into the general fund.

Historical and Projected Revenue

Table 1 shows total and general fund revenue from corporation license taxes for FY 1994 through FY 2004 and projections through FY 2007. Revenue grew fairly steadily during the 1990s as the national economy had a prolonged expansion. Revenue dropped by about 35% in FY 2002 and again in FY 2003 and increased by 53% in FY 2004. Revenue is projected to decrease in FY 2005 and then to be higher in FY 2006 and FY 2007 but to be significantly below peak collections of FY 2001.

Table 1
Corporation License Tax - General Fund Collections
(\$ millions)

	Fiscal Year	Total Collections	General Fund	Percent Change
A	1994	\$68.872	\$37.698	-26.5%
A	1995	\$75.520	\$57.918	53.6%
A	1996	\$75.762	\$59.360	2.5%
A	1997	\$81.999	\$64.079	7.9%
A	1998	\$77.928	\$69.725	8.8%
A	1999	\$89.625	\$80.142	14.9%
A	2000	\$99.089	\$90.683	13.2%
A	2001	\$103.670	\$103.670	14.3%
A	2002	\$68.173	\$68.173	-34.2%
A	2003	\$44.138	\$44.138	-35.3%
A	2004	\$67.723	\$67.723	53.4%
F	2005	\$62.448	\$62.448	-7.8%
F	2006	\$75.666	\$75.666	21.2%
F	2007	\$80.269	\$80.269	6.1%



Corporation license tax is more volatile and less predictable than most revenue sources. This volatility is even more apparent when corporation license tax revenue is broken down into its components: quarterly estimated payments; payments with returns; audit revenue, including penalties and interest; and refunds.

Table 2 shows FY 2000 through FY 2004 quarterly estimated payments, payments with returns or extensions, and payments of audit revenue, including penalties and interest. It also shows total collections, which is the sum of the three types of payments. The two rightmost columns show refunds and net revenue, which is total collections less refunds.

Table 2
Corporation License Tax Collections and Refunds
FY 2000 through FY 2004

Fiscal Year	Quarterly Estimated Payments		Payments with Returns or Extensions		Audit, Penalty and Interest		Total Collections		Refunds		Net Revenue	
	\$ million	% Chg	\$ million	% Chg	\$ million	% Chg	\$ million	% Chg	\$ million	% Chg	\$ million	% Chg
2000	86.070		13.186		1.208		100.464		-11.199		89.264	
2001	62.945	-27%	50.038	279%	0.000	-100%	112.983	12%	-9.312	-17%	103.670	16%
2002	46.986	-25%	31.879	-36%	4.927	N/A	83.792	-26%	-16.607	78%	67.185	-35%
2003	46.788	0%	18.723	-41%	7.876	60%	73.388	-12%	-29.452	77%	43.936	-35%
2004	50.447	8%	23.222	24%	13.689	74%	87.359	19%	-20.115	-32%	67.244	53%

Corporations expecting to have tax liability of at least \$5,000 are required to make quarterly estimated payments. Returns are due five months after the end of the tax year, but a corporation may have an automatic six-month extension and the Department of Revenue may grant additional extensions. Corporations taking an extension and expecting to have tax liability greater than their estimated payments generally make a tentative payment when their return is due. When a corporation files its return, it makes a final payment if its liability is more than the sum of its estimated and tentative payments. It claims a refund if its liability is less than it has paid.

Payments and refunds for a corporation's tax year may be spread over two or more fiscal years. Corporation license tax is paid for a twelve-month period. Many corporations start their tax years on January 1, but some start their tax year later in the calendar year. This means that collections during a fiscal year will be of taxes from at least four calendar years. For example, collections in FY 2004 would include quarterly estimated payments for parts of calendar years 2004 and 2003, and payments and refunds based on returns for tax years beginning in 2003, 2002, and the last months of 2001.

The minimum corporation tax payment for a year is \$50. When a corporation has a loss, it must still pay the minimum. However, it can carry the loss back to the previous three tax years and request a refund of taxes paid for those years. If the loss is more than can be carried back to the three previous years, it can be carried forward up to seven years.

The volatility of collections is due to unpredictability of taxes paid by individual corporations, not to instability in the number of corporations. Table 3 shows C-corporation tax returns filed for tax years 1996 through 2002. The second column shows the number of C-corporations that had filed a return for each of these tax years by the end of calendar 2003. To give a valid comparison, this needs to be adjusted for additional C-corporations that will file returns for the later years. The third column shows the percentage of additional returns expected to be filed by seven years after each tax year, and the fourth column shows the number of C-corporations expected to file a return for each tax year.

Slightly less than 70% of returns for a tax year are filed by the end of the following calendar year. Thus, the last row of Table 3 shows that 30.4% more returns are expected for tax year 2002 and 16,229 C-corporations ultimately are expected to file returns. After adjusting for the time to file returns, the number of C-corporations filing returns appears to have been stable from 1996 through 1998 and then to have grown steadily through 2002.

Table 3 C-Corporations Filing Tax Returns Tax Years 1996 through 2002			
Tax Year	Returns Filed Through 2003	Additional Returns Expected by Seven Years After Tax Year	Returns Expected by Seven Years After Tax Year
1996	15,360	0.00%	15,360
1997	15,306	0.11%	15,323
1998	15,299	0.22%	15,333
1999	15,423	0.73%	15,535
2000	15,479	1.61%	15,729
2001	15,408	3.60%	15,963
2002	12,446	30.40%	16,229

The average growth of corporation tax revenue is correlated with a number of measures of state and national economic performance. This makes it possible to predict average growth of collections. However, year-to-year variations in collections are only weakly correlated with variations in state or national economic performance. This makes it impossible to predict whether collections will grow faster or slower than average in any year with much precision.

Part of the volatility of collections in the last few years was caused by unusual events affecting a few taxpayers. Collection trends were estimated with the effects of these events removed. However, similar events may cause significant deviations from the trend in the future.

Changes in federal tax laws affect corporation license tax revenue because the base for the tax is Montana's share of taxable profits for federal corporate income tax. The Job

Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 allowed first year depreciation to be increased by 30% for purchases between September 10, 2001 and May 5, 2003 and by up to 50% for purchases between May 6, 2003 and December 31, 2004. This temporary change in accounting rules shifts profits and taxes from tax years 2001 through 2005 to later years.

Forecast Methodology

The following steps are used to forecast corporation license tax revenue:

- 1) Separate past collections into normal current collections and extraordinary collections, including collections from audits and one-time and other extraordinary events.
- 2) Separate normal collections from Step 1 into collections from corporations doing business solely within the state ("domestic" corporations) and multi-state corporations.
- 3) Forecast collections from domestic corporations.
- 4) Forecast collections from multi-state corporations.
- 5) Forecast audit and other extraordinary collections and sum the forecasts for domestic corporations, multi-state corporations and extraordinary collections to obtain the forecast of total collections.

Step 1: Separate Normal and Extraordinary Collections

For forecasting purposes, it is useful to separate corporate tax receipts into those due to current operating profits, which are affected by current economic conditions, and receipts due to audits and extraordinary events, which are not tied to current economic conditions.

The Department of Revenue audits a percentage of corporate taxpayers every year and collects revenue from audits every year. Each audit typically covers returns for several past years for the purpose of verifying and correcting the income and deductions reported on those returns. When the department determines that a return was incorrect, it notifies the taxpayer that additional tax, possibly with penalties and interest, is due or it issues a refund. Audit revenue for a year depends on the number of audits and the corrections made to returns from previous years and not on current economic conditions.

A corporation's profits during a year depend on current operations and on one-time transactions and accounting adjustments. When a firm sells assets, it may have a capital gain or loss. When a firm has assets that have lost value, it may write off that loss against current revenues. In either case, the firm's profits, which are the base for corporate tax, are affected by factors other than current operations.

When a corporation has losses in one year, it can carry those losses back to the three previous years and claim a refund of taxes paid in those years. If profits in the three previous years were less than the current loss, it can carry the loss forward to future tax years. In this case, corporate tax receipts in one year are affected by economic conditions in other years.

The Department of Revenue examined records of corporate tax payments from FY 1993 through FY 2003 and identified revenue and refunds from audits and known large extraordinary events. For FY 2004, audit collections were taken from the state accounting system, and the effects of temporary changes in federal depreciation rules were estimated by recalculating tax liability from returns for earlier years as if the temporary depreciation rules had been in effect.

Table 4 shows net collections from audits and one-time events, other collections, which are assumed to be from current operating profits, and total collections.

Table 4 Audit and One-Time Collections and Other Collections FY 1993 through FY 2004 (\$ millions)			
Fiscal Year	Audit and One-Time Collections	Other Collections	Total Collections
1993	\$31.314	\$53.740	\$85.054
1994	\$12.022	\$56.850	\$68.872
1995	\$13.916	\$61.604	\$75.520
1996	\$10.266	\$65.496	\$75.762
1997	\$15.634	\$66.365	\$81.999
1998	\$11.790	\$66.138	\$77.928
1999	\$37.042	\$52.582	\$89.625
2000	\$30.609	\$68.479	\$99.089
2001	\$25.267	\$78.404	\$103.670
2002	\$10.216	\$57.957	\$68.173
2003	(\$12.922)	\$57.060	\$44.138
2004	\$3.777	\$63.946	\$67.723
average	\$15.744	\$62.385	\$78.129
high - low	\$49.964	\$25.822	\$59.533

Over the twelve fiscal years shown in Table 4, audit and one-time revenue averaged \$15.7 million but ranged from a high of \$37.0 million in FY 1999 to a low of (\$12.9) million in FY 2003. Other collections showed less variation. While other collections averaged almost four times more than audit and one-time collections, the difference between the highest and lowest was almost twice as large for audit and one-time collections.

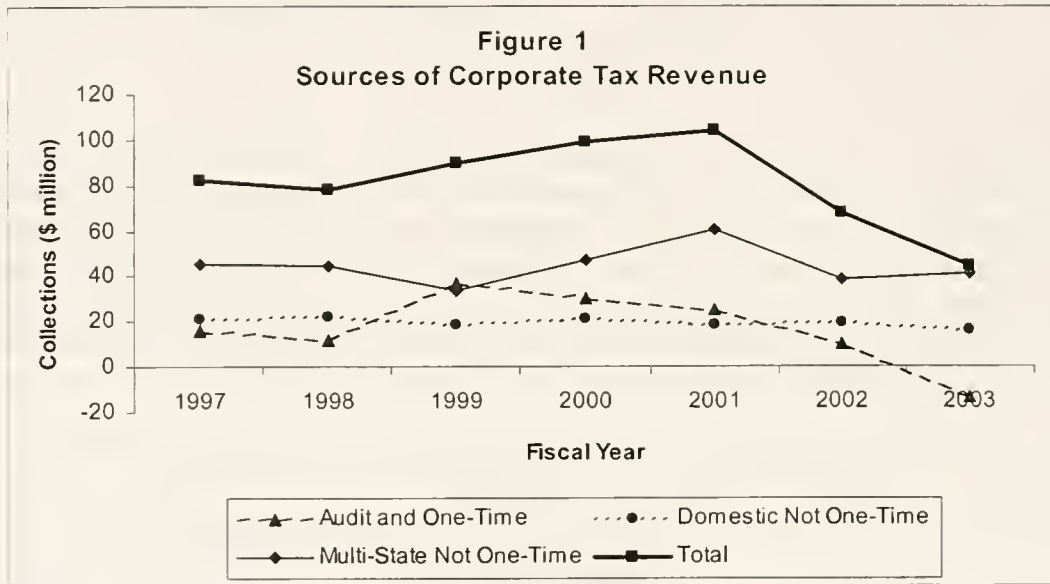
Step 2: Separate Collections from Domestic and Multi-State Corporations

Corporations doing business in more than one state apportion their income among the states for corporate tax purposes. This provides an easy way to differentiate between multi-state corporations and corporations that only do business in Montana, which are referred to as domestic corporations. The Department of Revenue examined returns from FY 1997 through FY 2003 and separated the other corporate tax payments shown in Table 4 into domestic and multi-state corporations.

Table 5 shows collections not attributable to audits or one-time events from domestic corporations and multi-state corporations for FY 1997 through FY 2003. It also shows the averages and the range from highest to lowest. Revenue from multi-state corporations has the most variation. On average, it is more than twice the revenue from domestic corporations, but the range from highest to lowest is almost five times as large. In fact, the range of collections from multi-state corporations is greater than the range of total collections (not attributable to audits or one-time events).

Table 5 FY 1997- FY 2003 Domestic and Multi-State Corporation Collections (\$ millions)			
Fiscal Year	Domestic Corporations	Multi-State Corporations	Total Not Audit or One- Time
1997	\$20.729	\$45.636	\$66.365
1998	\$21.580	\$44.559	\$66.138
1999	\$18.781	\$33.801	\$52.582
2000	\$21.076	\$47.404	\$68.479
2001	\$18.279	\$60.125	\$78.404
2002	\$19.223	\$38.735	\$57.957
2003	\$16.097	\$40.963	\$57.060
average	\$19.395	\$44.460	\$63.855
high - low	\$5.483	\$26.324	\$25.822

Figure 1 shows total corporate tax collections on the top line, comprised of audit and one-time collections; collections from domestic corporations not due to audits or one-time events; and collections from multi-state corporations not due to audits or one-time events. Collections from domestic corporations are by far the most stable of the three sources of revenue.

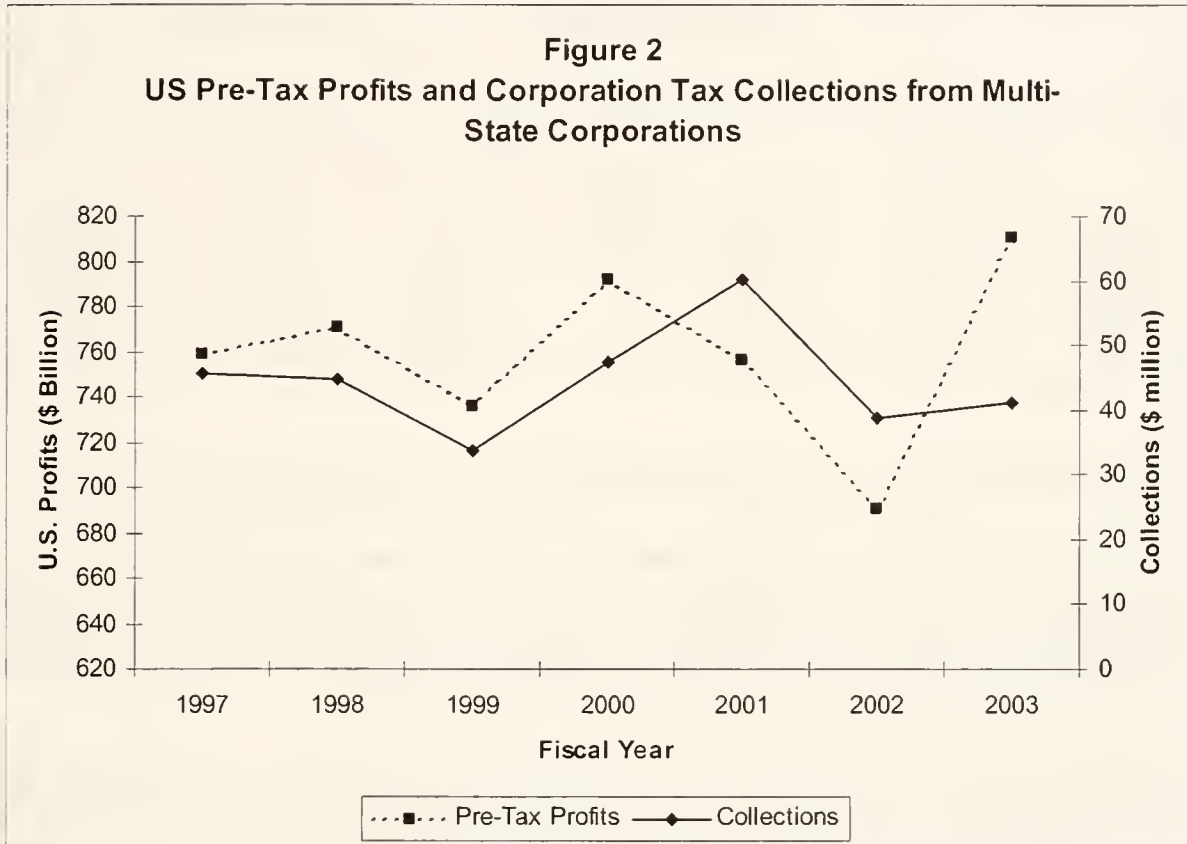


Step 3: Forecast Collections from Domestic Corporations

As shown in Table 5 and Figure 1, collections from domestic corporations were fairly stable from FY 1997 through FY 2003, with small variations from year to year and no trend. The forecast assumes that this will continue to be true. Collections from domestic corporations are forecast to equal the average from FY 2001 through FY 2003, which is \$17.866 million.

Step 4: Forecast Collections from Multi-State Corporations

Multi-state corporations pay Montana corporate tax on a percentage of their total income. This percentage is the average of the percentages of the corporation's property, payroll, and sales that are in Montana. Figure 2 shows U.S. pre-tax profits and corporate tax receipts from multi-state corporations.



U.S. pre-tax profits and corporate tax collections from multi-state corporations generally move together. From FY 1997 through FY 2003, they moved in the same direction in five out of seven years.

A statistical model was developed to forecast collections from multi-state corporations based on a time trend and U.S. corporate profits. The model with the best fit to the data predicts that collections will equal \$44.314 million, which is average collections from FY 1993 through FY 2003, plus \$0.086 million for each year since FY 1998, plus \$16.441 million for each trillion dollars by which U.S. corporate profits exceed \$0.710 trillion, their average from FY 1993 through FY 2003.

Table 6 shows the calculation of the forecast for FY 2004 through FY 2007 using this model. The forecast of U.S. corporate profits shown in Table 6 is derived from Global Insight's September 2004 forecast. To avoid double counting the effect of federal bonus depreciation provisions, the U.S. profit forecast was adjusted to remove them. This was done by using profits in FY 2001 as the baseline and applying the growth rate of Global Insight's forecast of profits plus depreciation to this baseline.

Table 6 Forecast of Collections From Multi-State Corporations										
Fiscal Year	Average Collections FY 1993 - FY 2003		Growth per Year		Years Since FY 1998		Increase per \$1 Trillion in US Profits		US Profits - FY93 to FY03 Average	Model Forecast
2005	\$44.314	+	\$0.086	x	7	+	\$16.441	x	\$0.466	= \$52.582
2006	\$44.314	+	\$0.086	x	8	+	\$16.441	x	\$0.524	= \$53.622
2007	\$44.314	+	\$0.086	x	9	+	\$16.441	x	\$0.587	= \$54.736

Step 5: Adjust Total Collections for Anticipated Audit and One-Time Impacts

The final step in the revenue estimate is to add total collections from domestic and multi-state corporations and adjust this total for one-time or extraordinary adjustments and audit revenue. There are two extraordinary adjustments. One is for loss carryforwards continuing in FY 2005, and the other is for the impact of the accelerated depreciation provisions in effect through December 31, 2004.

During the economic slowdown of 2001 and 2002, many corporations had losses. Some of these losses were carried back to offset income in the previous three years. The resulting refunds of taxes paid in 1998 through 2000 reduced revenue in FY 2002 and FY 2003. Losses that cannot be carried back can be carried forward for up to seven years. An analysis of returns filed in FY 2004 indicates that corporations have accumulated significant unused loss carryforwards. As the economy continues to improve, more companies will have profits that they can offset with accumulated loss carryforwards. It is estimated that use of these loss carryforwards will result in a one-time decrease in collections of \$9 million in FY 2005.

The Department of Revenue examined corporate tax returns for 1998, 1999, and 2000 and calculated what tax liability for those returns would have been if those returns had been filed each year when the bonus depreciation rules will be in effect. The changes from actual liability were used to estimate the impact of bonus depreciation. Through FY 2005, the accelerated depreciation reduces tax liability. After FY 2005, the remaining depreciation on capital goods purchased during the bonus depreciation window is lower than it would have been without the accelerated depreciation. This increases tax liability for several years beginning in FY 2006.

The Department of Revenue makes an estimate of the audit revenue the department will generate by fiscal year. They have estimated \$3.5 million for FY 2005 and FY 2006, and \$4 million for FY 2007.

Table 7 shows estimated collections from domestic and multi-state corporations, adjustments for extraordinary loss carryforwards and bonus depreciation, audit revenue, and total forecast collections for FY 2005 through FY 2007.

Table 7 FY 2005 through FY 2007 Corporation License Tax Forecast (\$ millions)			
Forecast Item	FY2005	FY2006	FY2007
Revenue from Multi-State Corporations	\$52.582	\$53.622	\$54.736
Revenue from Domestic Corporations	17.866	17.866	17.866
Total Revenue Before Adjustments	\$70.448	\$71.488	\$72.602
Adjustments:			
Extraordinary Loss Carryforwards	(\$9.000)	\$0.000	\$0.000
30% Bonus Dep./Bus. Exp. Impacts	(2.000)	0.678	3.667
Audit Revenue	3.000	3.500	4.000
Total Adjustments	(\$8.000)	\$4.178	\$7.667
Forecast Corporate Tax Collections	\$62.448	\$75.666	\$80.269

Total collections are projected to be \$5.2 million lower in FY 2005 than in FY 2004, primarily because adjustments are negative. Revenue before adjustments is projected to grow by slightly more than \$1 million per year in FY 2006 and FY 2007. After adjustments, revenue is projected to grow by \$13.2 million in FY 2006 and by \$4.6 million in FY 2007.

Forecast Risk

This forecast is based on the trends in collections that can be seen when extraordinary events in the past have been taken into account. On average, collections are expected to continue to follow the same trends in the future. However, extraordinary events are almost certain to occur in the future. In any year, collections may be significantly higher or lower than the trend.

INSURANCE PREMIUMS TAX

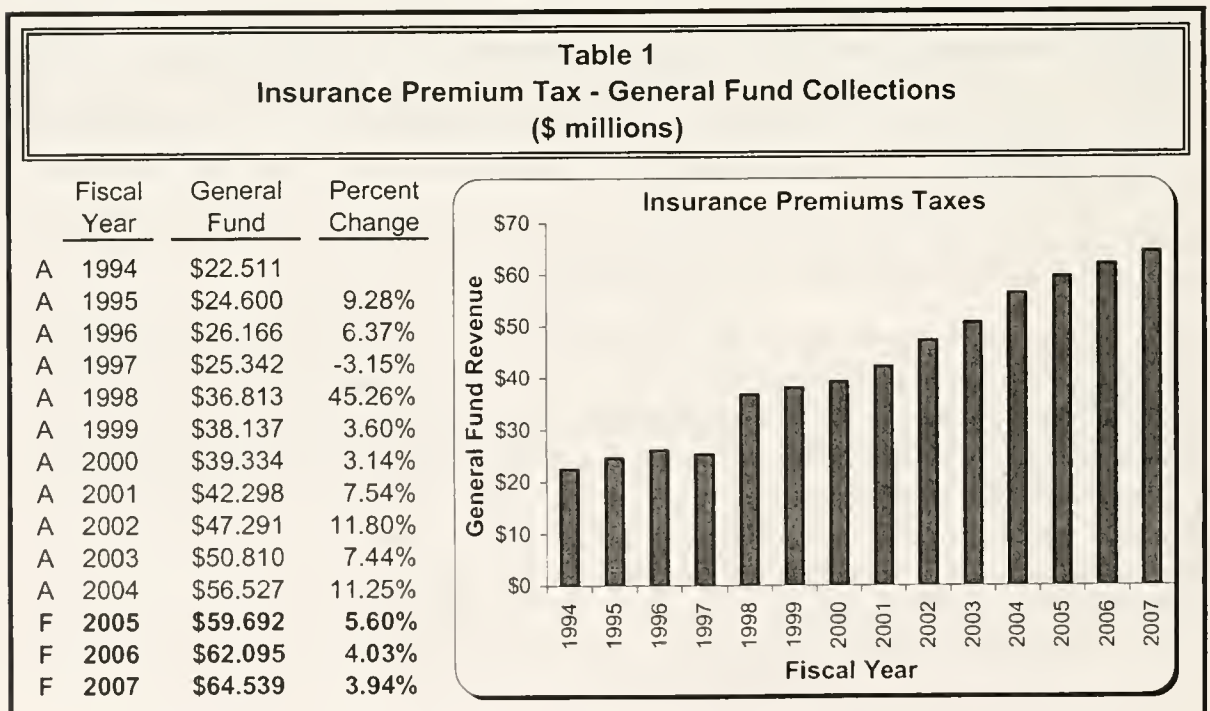
Revenue Description

Montana levies a tax of 2.75% on net premiums on all insurance policies (33-2-705, MCA) except health service corporations, which are exempt from all premium taxes under 33-30-203, MCA. There is an additional tax of 2.5% on premiums for fire and casualty insurance on property, insurance of property in transit, insurance against loss or damage to motor vehicles, crop insurance, insurance against water damage, insurance against property damage from vehicle accidents, and insurance against theft of a vehicle (50-3-109, MCA).

Section 33-2-712, MCA, provides for a genetics program fee of \$0.70 per each Montana resident insured under any individual or group disability or health insurance policy. This fee is used to fund the statewide genetics program established in 50-19-211, MCA.

Historical and Projected Revenue

Table 1 shows actual insurance premiums taxes for FY 1994 through FY 2004, and projected revenue for FY 2005 through FY 2007. Prior to FY 1998, a portion of the premiums tax revenue was paid into pension and benefit funds for police officers and firefighters. Beginning in FY 1998, all premiums taxes are deposited in the general fund, explaining the large increase in revenue shown in Table 1 for that year.



The forecast anticipates growth in insurance tax revenue to slow in FY 2005 and subsequent years. The growth in premium tax, along with fire and casualty surtax, is expected to be significantly lower than was observed in recent years. Additionally, because a large health service corporation, which does not pay the insurance premiums tax, assumed a company previously paying the insurance premium tax, the State Auditor's Office expects a \$600,000 per year decrease in the premium tax.

Forecast Methodology and Projection Calculation

Insurance premiums tax receipts depend on the value of insurance premiums, and on deductions that insurance companies are allowed to take against their tax liabilities. Genetics program fees depend on the number of residents covered by disability and health insurance policies.

Insurance Premiums Tax

An insurance company's premiums tax liability is the tax rate multiplied by its annual premiums, less deductions. Total premiums depend on the amount of insurance coverage that consumers and businesses buy, and the price that insurance companies charge for that coverage.

The price of insurance is influenced by insurance companies' investment earnings. Insurance companies set their rates so that the sum of premiums and investment earnings will pay the average level of claims, along with dividends to the owners. Insurance companies maintain reserves to cover unexpected high claims. They invest these reserves in corporate and government securities, mortgages, real estate, and other assets. When income from these investments is high, insurance companies can reduce their rates. When investment income is low, insurance companies must raise their rates. The dramatic run-up in the price of stocks from 1996 through 2000 gave insurance companies unexpected capital gains, which allowed them to hold down rates.

In FY 1998 and FY 1999, premiums tax revenue decreased, as capital gains from the rising stock market allowed insurance companies to reduce premiums. Average stock prices grew slower in FY 2000, peaked and began to fall in FY 2001, and plunged in FY 2002. As the stock market slowed, insurance companies were no longer able to reduce rates, and total premiums began to grow again. Beginning in FY 2002, insurance companies were forced to raise their rates, and premiums tax revenues grew much faster than normal.

Insurance premiums tax, before any tax offsets, grew by approximately 10% each year from FY 2002 to FY 2004. However, as the stock market recovers and interest rates rise, earnings from these sources should decrease the upward pressure on premiums. The top portion of Table 2 shows growth in the base premiums tax, before offsets for FY 1998 through FY 2004. The average annual growth in base premiums tax from FY 1998 to FY 2004 was 6.75%.

The average annual growth of 6.75% is used to estimate base premiums tax for FY 2005. However, a downward adjustment of \$600,000 is made to account for the aforementioned health service corporation assuming another insurance business. As Table 2 shows, the (\$600,000) adjustment reduces estimated growth to 5.55% for FY 2005.

The stock market and interest rates are expected to have a more robust earning potential in FY 2006 and FY 2007. It is assumed that with more robust earnings, insurance companies will be able to hold premiums down. FY 2006 and FY 2007 base insurance premiums tax revenue is projected using a 4.0% growth rate.

Table 2 Insurance Premiums Tax Growth Before Offsets		
Fiscal Year	Base Premiums Tax Before Offsets (\$ million)	% Growth
1998	\$36.211	
1999	\$35.674	-1.48%
2000	\$37.834	6.06%
2001	\$39.874	5.39%
2002	\$44.803	12.36%
2003	\$48.630	8.54%
2004	\$53.582	10.18%
6 Year Average Growth =		6.75%
2005	\$56.558	5.55%
2006	\$58.820	4.00%
2007	\$61.173	4.00%

Insurance Premiums Tax - Offsets

Companies are allowed to deduct amounts they are assessed by the Montana Life and Health Insurance Guarantee Association (MLHIGA) and the Montana Comprehensive Health Association (MCHA).

MLHIGA protects policyholders against insurance company insolvencies. When an insurance company doing business in Montana becomes insolvent, MLHIGA covers its liabilities by making assessments against all the other insurance companies. These assessments may last for up to five years. MLHIGA assessments were unusually high in the mid-1990s because of the bankruptcy of a single large insurance company. As Table 3 shows, MLHIGA assessments have been decreasing since FY 1998, and the State Auditor's Office expects them to continue to decrease during the forecast period.

MCHA subsidizes health insurance for high-risk individuals, such as people with serious pre-existing conditions. In most years, the sum of premiums paid by high-risk policyholders is less than their total claims. MCHA reimburses companies that insure high-risk individuals for their losses on these policies. It covers these losses by making assessments against the other insurance companies. Blue Cross Blue Shield (BCBS) administers the MCHA program; BCBS anticipates the amount of MCHA reimbursements to be \$910,000 in FY 2005, and then increase by 5% each year.

As Table 3 shows, total offsets are projected at \$1.128 million for FY 2005, \$1.120 million in FY 2006, and \$1.168 million in FY 2007

Table 3 MLHIGA and MCHA Offsets (\$ millions)			
Fiscal Year	MLHIGA Offsets	MCHA Offsets	Total Offsets
1998	\$2.801	\$0.229	\$3.030
1999	\$1.936	\$0.702	\$2.638
2000	\$1.354	\$0.729	\$2.083
2001	\$0.587	\$0.274	\$0.861
2002	\$0.259	\$0.481	\$0.740
2003	\$0.374	\$1.089	\$1.463
2004	\$0.368	\$0.957	\$1.325
2005	\$0.218	\$0.910	\$1.128
2006	\$0.165	\$0.955	\$1.120
2007	\$0.165	\$1.003	\$1.168

Surtax on Fire and Casualty Insurance

Table 4 shows actual and projected surtax revenue collections on fire and casualty insurance for FY 2000 through FY 2007. As Table 4 illustrates, surtax revenue, like the base insurance premium tax, grew significantly from FY 2000 to FY 2004.

The forecast assumes that growth in surtax revenue on fire and casualty insurance will follow the growth in the base insurance premium tax. As previously discussed, the unadjusted growth in the base insurance tax is projected at 6.75% for FY 2005, and 4.00% for FY 2006 and FY 2007. Using these growth rates yields estimated surtax revenue of \$3.277 million in FY 2005, \$3.408 million in FY 2006, and \$3.544 million in FY 2007.

Table 4
Insurance Premiums
Fire/Casualty Surtax

Fiscal Year	Surtax (\$ millions)	% Growth
2000	\$2.012	
2001	\$2.206	9.63%
2002	\$2.367	7.34%
2003	\$2.701	14.09%
2004	\$3.070	13.65%
2005	\$3.277	6.75%
2006	\$3.408	4.00%
2007	\$3.544	4.00%

Genetics Program Fees

Section 50-19-211, MCA, provides for a voluntary genetics program designed to offer testing, counseling, and education to parents and prospective parents. A fee, paid by insurers or health service corporations, of \$0.70 for each Montana resident insured under any individual or group disability or health insurance policy, funds this program. The fee is deposited in the general fund.

Table 5 shows actual and projected genetics program fees from FY 1994 through FY 2007. In recent years, the number of insured persons has varied from 86% to 100% of the population. The percentage fluctuates from year to year due to changes in the percent of uninsured persons, and persons covered by more than one policy. The forecast assumes that the number of insured persons will remain at the FY 2004 level of 90.1% of the state population for FY 2005 through FY 2007.

Table 5
Genetics Program Fee

Fiscal Year	State Population	Percent Insured	Insured Persons	Fee per Insured Person	General Fund Revenue
A 1998	895,601	x 91.6%	= 820,584	x \$0.70	= \$574,409
A 1999	901,175	x 91.8%	= 827,135	x \$0.70	= \$578,995
A 2000	904,988	x 85.6%	= 774,854	x \$0.70	= \$542,398
A 2001	908,714	x 99.8%	= 907,003	x \$0.70	= \$634,902
A 2002	914,898	x 89.0%	= 813,987	x \$0.70	= \$569,791
A 2003	920,103	x 87.5%	= 804,855	x \$0.70	= \$563,399
A 2004	924,064	x 90.1%	= 832,794	x \$0.70	= \$582,956
F 2005	927,900	x 90.1%	= 836,251	x \$0.70	= \$585,375
F 2006	931,566	x 90.1%	= 839,555	x \$0.70	= \$587,688
F 2007	935,331	x 90.1%	= 842,948	x \$0.70	= \$590,064

General Fund Revenue

Table 6 shows general fund revenue forecasts for FY 2005 through FY 2007. Total revenue to the general fund is the sum of insurance premiums tax minus the offsets, plus the surtax, the genetics fee, and various insurance licenses and permits.

Table 6								
Total Insurance Premiums Tax General Fund Collections								
(\$ millions)								
Fiscal Year	Insurance Premiums Tax	Offsets	Fire/Casualty Surtax	Genetics Fee	Licenses & Permits	General Fund Revenue		
F 2005	\$56.558	- \$1.128	+ \$3.277	+ \$0.585	+ \$0.400	=	\$59.692	
F 2006	\$58.820	- \$1.120	+ \$3.408	+ \$0.588	+ \$0.400	=	\$62.095	
F 2007	\$61.173	- \$1.168	+ \$3.544	+ \$0.590	+ \$0.400	=	\$64.539	

The amount of revenue received for various insurance licenses and permits has averaged approximately \$400,000 per year since FY 2002. For purposes of this analysis, \$400,000 per year is used to estimate various insurance licenses and permits over the forecast period.

Total general fund insurance premiums tax revenue is projected to be \$59.7 million in FY 2005, \$62.1 million in FY 2006, and \$64.5 million in FY 2007.

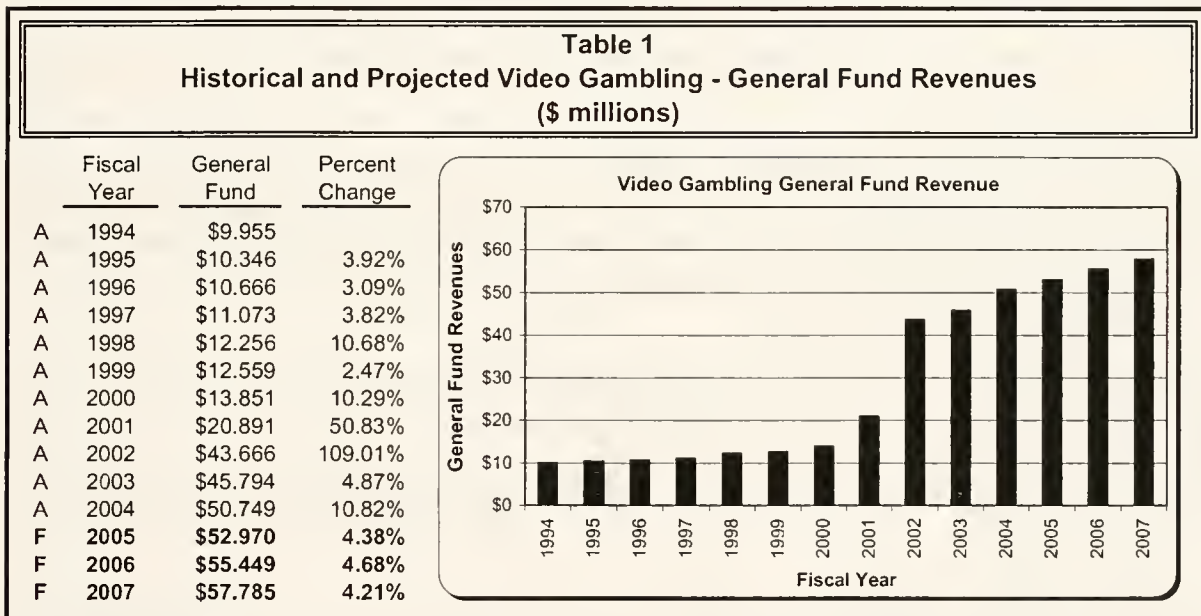
VIDEO GAMBLING TAX

Revenue Description

Section 23-5-610, MCA, establishes the video gambling machine gross income tax. It is a tax applied to the gross machine income received from video poker and keno machines. Gross machine income is the difference between total receipts from a machine minus its cash payouts. The tax rate is 15% of gross machine income. Tax collections are deposited in the state general fund.

Historical and Projected Revenue

Table 1 shows historical and projected general fund revenue from the video gambling tax for FY 1994 through FY 2007.



As Table 1 shows, general fund revenues from the video gambling tax have increased each year since FY 1994. Video gambling tax revenue is estimated to increase 4.38% in FY 2005, 4.68% in FY 2006, and 4.21% in FY 2007.

HB 124 (2001 session) changed the distribution of the video gambling tax. Prior to the fourth quarter in FY 2001, two-thirds of the tax was distributed to the county or municipal government where the machine was located, and one-third of the tax was deposited in the state general fund. Beginning with the fourth quarter in FY 2001, the tax collections are deposited in the state general fund. This change in distribution of the tax explains the large increase in general fund revenue in FY 2001 and FY 2002.

Forecast Methodology and Projected Calculation

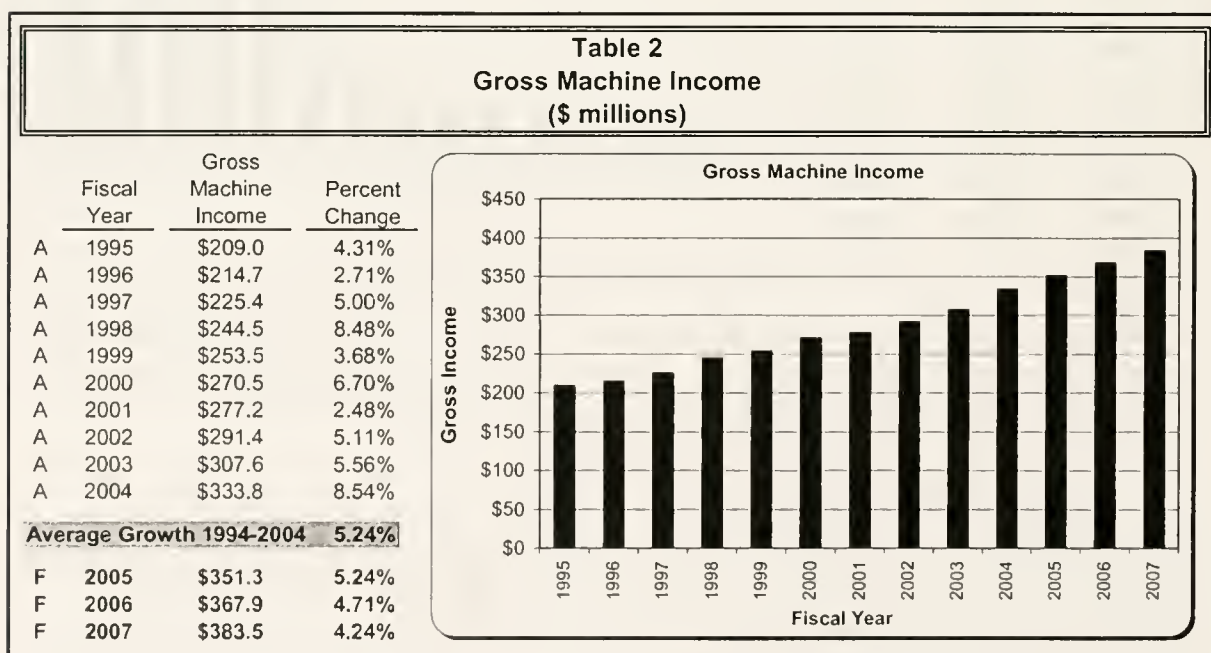
There are three steps in estimating general fund revenue from the video gambling tax: 1) forecast gross machine income; 2) forecast annual permit surcharge fees; and 3) apply the tax rate to gross machine income and add the amount of surcharge fees.

Step 1: Calculate Gross Machine Income

Gross machine income is the difference between total receipts from all video gambling machines and cash payouts. Multiplying gross machine income by the tax rate, then adding gaming surcharge fees closely approximates general fund revenue for each fiscal year. Actual general fund revenue differs slightly due to penalties assessed and refunds given by the Department of Justice. Neither penalties assessed nor refunds have a significant impact on tax collections.

Table 2 shows actual and projected gross machine income for FY 1994 through FY 2007. As Table 2 illustrates, gross machine income has increased steadily since FY 1994. The average annual change from FY 1994 to FY 2004 is 5.24%.

In FY 2004, gross machine income increased by 8.54%. The primary explanation for the higher than average growth in FY 2004 is that the gambling industry, by replacing older machines and software packages in recent years, has attracted more play. Growth in Montana's per capita income, and increased tourism due to the Lewis & Clark Bicentennial festivities are other factors that may have contributed to the higher than average growth in FY 2004.



This analysis assumes that, as the novelty of the new machines and software wears off, gross machine income will return to historical levels of growth. Gross machine income for FY 2005 is projected forward using the average annual rate from FY 1994 through FY 2004 of 5.24%. Growth in gross machine income for FY 2006 and FY 2007 is expected to be slightly lower each year, again as the novelty of new machines and software packages continues to wear off. Estimated growth in gross machine income for FY 2006 and FY 2007 is derived by taking 90% of the prior year's growth. Projected growth is 4.71% ($5.24\% \times 90\%$) for FY 2006, and 4.24% ($4.71\% \times 90\%$) for FY 2007.

As shown in Table 2, gross machine income is estimated at \$351.3 million in FY 2005, \$367.9 million in FY 2006, and \$383.5 million in FY 2007.

Step 2: Estimate Annual Surcharge Fee

HB 758 (2003 session) added an additional surcharge fee that is assessed on each video gambling machine. The fee is \$10 per machine for establishments having fewer than 20 machines on the premises, and \$20 on each machine for establishments that have more than 20 machines on location.

As Table 3 shows, in FY 2004 there were 20,510 active machines that paid an average \$13.32, for a total of \$273,275 dollars. For FY 2005, it is anticipated that there will be the same number of active machines and the same average tax per machine will apply as in FY 2004. The number of active machines in FY 2006 and FY 2007 is estimated to decline by 1.0 %, or 200 machines each year, due to the availability of the new multi-game software.

With the decline due to availability of the new multi-game software, it also is assumed that some establishments, which currently have at least 20 machines and pay the higher fee, will fall below the 20 machines threshold and pay the lesser fee of \$10. For purposes of this analysis, the average fee per machine also is anticipated to decrease 1.0% or about \$0.13 cents per year.

Permit surcharge fees are estimated at \$273,275 in FY 2005, \$267,837 in FY 2006, and \$262,507 in FY 2007.

Table 3 Annual Permit Surcharge Fee			
Fiscal Year	Est. Number Machines	Est. Ave. Tax Per Machine	Total Tax
A 2004	20,510	\$13.32	\$273,275
F 2005	20,510	\$13.32	\$273,275
F 2006	20,305	\$13.19	\$267,837
F 2007	20,102	\$13.06	\$262,507

Step 3: Calculate General Fund Video Gambling Tax Revenue

Table 4 shows the general fund revenue calculation for the video gambling machine tax for FY 2004 through FY 2007. Video gambling machine income from Table 2, multiplied by the tax rate of 15% yields gross machine income tax collections. Gross machine income tax collections plus the annual surcharge fee amounts listed in Table 3, yields total general fund revenue collections.

Table 4			
Calculation of General Fund Video Gambling Tax			
FY 2004 through FY 2007			
<u>Description</u>	<u>FY 2005</u> <u>Estimated</u>	<u>FY 2006</u> <u>Estimated</u>	<u>FY 2007</u> <u>Estimated</u>
Video Gambling Income	\$351,314,191	\$367,876,307	\$383,484,926
Multiply by Tax Rate	15%	15%	15%
Gross Tax Collections	\$ 52,697,129	\$ 55,181,446	\$ 57,522,739
Add Permit Surcharge Fee	273,275	267,837	262,507
General Fund Revenue	\$ 52,970,404	\$ 55,449,283	\$ 57,785,246

General fund revenue over the forecast period is \$52.970 million for FY 2005, \$55.449 million for FY 2006, and \$57.785 million for FY 2007.

COMBINED OIL AND NATURAL GAS PRODUCTION TAX

Revenue Description

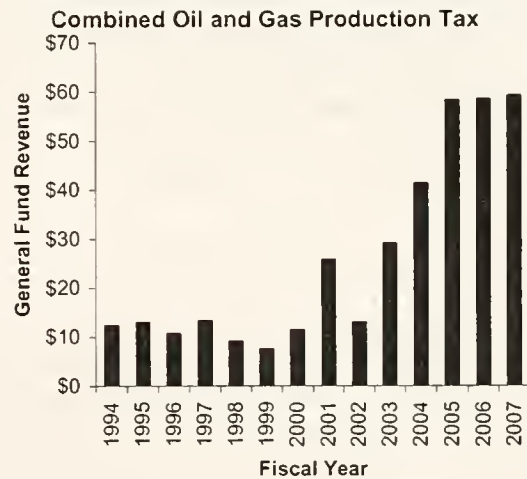
Montana taxes the gross value of oil and natural gas production. Tax rates depend on the type of production, with incentives for new production, horizontal wells, secondary and tertiary production, and stripper wells. Working interest owners, who share in a well's costs, pay lower rates than royalty recipients, who do not share in a well's costs. Revenues are distributed to a variety of state and local accounts. On average, about 43% of revenue from the oil and natural gas production tax is deposited in the general fund.

Historical and Projected Revenue

Table 1 shows actual general fund revenue from the oil and gas production tax for FY 1994 through FY 2004 and forecasts for FY 2005 through FY 2007.

Table 1
Combined Oil and Natural Gas Production Tax - General Fund Collections
(\$ millions)

	Fiscal Year	Total Collec-tions	General Fund	Percent Change
A	1994	\$40.871	\$12.289	-34.20%
A	1995	\$34.704	\$12.964	5.49%
A	1996	\$40.826	\$10.666	-17.73%
A	1997	\$50.150	\$13.283	24.54%
A	1998	\$35.709	\$9.120	-31.34%
A	1999	\$30.447	\$7.506	-17.70%
A	2000	\$43.773	\$11.363	51.39%
A	2001	\$92.396	\$25.792	126.99%
A	2002	\$50.304	\$12.902	-49.97%
A	2003	\$73.389	\$29.086	125.43%
A	2004	\$92.676	\$41.324	42.07%
F	2005	\$135.244	\$58.296	41.07%
F	2006	\$135.770	\$58.505	0.36%
F	2007	\$137.347	\$59.182	1.16%



General fund receipts from the oil and natural gas tax averaged \$12.9 million for FY 1994 through FY 2002. Receipts in FY 2001 were higher primarily because they included about \$6 million in back taxes from previous years.

General fund revenue in FY 2003 and FY 2004 was \$29.1 million and \$41.3 million respectively. There are two reasons for this higher general fund revenue. One is the change in the tax distribution due to HB 748 passed by the 2003 legislature. Before HB 748, the share of oil and natural gas tax the state returned to the counties was distributed in proportion to mill levies. Because the state levies 95 mills to support schools, part of the state's share of oil and natural gas tax was paid to the state as non-levy property tax revenue. Beginning with calendar year 2003, rather than send this revenue to the county for the county to return to the state when the mill levy distribution is made, the state's general fund share of the oil and natural gas tax is deposited directly in the general fund. This deposit is made under the oil and natural gas tax category rather than under the property tax revenue category, as was done previously when it was categorized as non-levy revenue. Second, HB 10 passed by the 2002 special session temporarily reallocated all but \$400,000 of the state's share of oil and natural gas tax that is normally allocated for resource indemnity to the general fund.

In FY 2005 through FY 2007, collections are projected to be higher than in FY 2004 due to higher prices and production.

Forecast Methodology and Projection Calculation

The five steps to estimate oil and natural gas production tax general fund revenue are:

- 1) Estimate average price by product and category of well;
- 2) Estimate production by product and category of well;
- 3) Estimate the taxable value of production by product, category of well, and type of ownership interest;
- 4) Estimate tax liability by product, category of well, and type of ownership interest; and
- 5) Allocate revenue between the general fund and other funds.

Prices

Oil and gas prices vary across the North American market depending on the chemical characteristics of the oil or natural gas and the cost of getting it to market. Prices in all parts of the continent move together, and *Montana prices generally follow national trends very closely*. Prices are forecast for each of the twenty categories of oil and gas production defined in the law. The actual average price for each category in FY 2003 was calculated from tax returns. The price for each category was then forecast by applying national price changes to these baseline prices.

Table 2 shows actual annual average prices for FY 2003 and FY 2004 along with forecasts through FY 2007.

The second column shows spot and futures prices for the standard New York Mercantile Exchange contract for West Texas Intermediate crude oil.

The third column shows average Montana wellhead oil prices. For FY 2003 and FY

2004, this is the actual average calculated from tax returns. For FY 2005 through FY 2007, this column shows the average of the forecasts of Montana wellhead prices for the fourteen oil production categories. The dollar values of regional differences in oil prices are relatively constant because they reflect differences in transportation costs and oil quality. Therefore, the forecast assumes that Montana oil prices will change by the same amount each year as the price of West Texas Intermediate. The change in the average Montana price is slightly different from the change in the price of West Texas Intermediate because prices vary across categories, and the mix of production among categories is changing over time.

The average price of West Texas Intermediate was \$9.02 higher in FY 2003 than the average over the previous ten fiscal years. The West Texas Intermediate price also averaged \$3.84 higher in FY 2004 than in FY 2003. Oil prices are expected to peak in FY 2005 and then decline slightly. Higher oil prices are due to growing world demand, particularly in developing countries, and a weaker dollar, which makes all imports more expensive.

The fourth column shows spot and futures prices for the standard New York Mercantile Exchange contract for natural gas of standard heat content delivered at the Henry Hub in Louisiana. The fifth column shows average Montana wellhead natural gas prices. For FY 2003 and FY 2004, this is the actual average calculated from tax returns. For FY 2005 through FY 2007, it shows the average of the forecasts of Montana prices for the six natural gas production categories. Regional differences in natural gas prices generally are relatively constant in percentage terms. This is because they reflect differences in transportation costs that are partly paid in kind. Montana prices for each production category are forecast to change by the same percentage as the Henry Hub price.

Natural gas prices are projected to increase in FY 2005 and then decline slightly. Oil and natural gas prices tend to move together. Many large energy users can burn either fuel, so that growth in energy demand translates into growth in demand for both natural gas and oil.

Table 2 Oil and Natural Gas Prices				
Fiscal Year	West Texas Intermediate, \$/bbl	Montana Average Oil Price, \$/bbl	Henry Hub Gas Price, \$/mcf	Montana Average Gas Price, \$/mcf
A 2003	\$29.91	\$27.27	\$4.78	\$3.26
A 2004	\$33.75	\$29.76	\$5.47	\$4.05
F 2005	\$46.52	\$42.78	\$7.09	\$5.23
F 2006	\$41.48	\$36.93	\$6.82	\$5.01
F 2007	\$39.03	\$34.39	\$6.18	\$4.52

Production

Oil production in Montana peaked in 1968 and is now approximately one-fourth its peak level. Oil production decreased every fiscal year from 1987 through 2000 but has increased slightly since then in response to higher prices.

Natural gas production showed no consistent trend from 1970 through about 1997. Natural gas production in 1998 was slightly higher than previous peaks in 1973 and 1981, and new production records were set in FY 2000, FY 2001, FY 2002, and FY 2004. Production in FY 2003 was slightly lower than in FY 2002.

For tax purposes, oil and natural gas production in Montana is divided into 20 categories depending on the product, year of initial production, the well's average daily output, and the drilling and production technologies used. Production is forecast separately for each category. Actual production numbers were obtained from tax returns. These numbers were used as a baseline; with future production projected using estimated prices and recent production trends.

Table 3 shows actual oil and natural gas production through FY 2004 and forecast production through FY 2007. In any year, new wells begin producing and production from old wells declines.

Over the forecast period, total production is predicted to grow because new production is expected to be greater than the decline in production from old wells.

Table 3		
Oil and Natural Gas Production		
Fiscal Year	Oil Production (bbl)	Gas Production (mcf)
A 2001	15,735,738	71,504,569
A 2002	16,602,797	79,606,968
A 2003	17,619,494	78,768,600
A 2004	20,981,872	84,631,718
F 2005	24,898,259	95,104,127
F 2006	28,456,238	104,056,224
F 2007	31,478,351	111,708,332

New Production

New production is forecast based on projected prices and recent drilling activity. Drilling in Montana in 2003 and 2004 has been higher than in any of the previous ten years. The number of drilling rigs operating in Montana increased by 75% from 2002 to 2003; and, through September, has increased 50% in 2004. With both oil and natural gas prices high and expected to remain high for the next several years, the current pace of drilling is likely to continue.

The forecast assumes that new natural gas and oil production will increase by 20% in FY 2005, and remain constant in FY 2006 and FY 2007.

Old Production

There are four reasons why production in the old production categories changes from year to year. First, for most old production categories, wells move into the category from one or more other categories every year. For example, last year's new production wells move into an old production category.

Second, the output of individual wells changes from year to year. In normal operation, output from an individual well declines over time as the stock of recoverable hydrocarbons in the reservoir is extracted and as removal of fluids through the well causes underground pressure to decrease. In addition, well operators generally have some flexibility to adjust production in response to price movements. They can slow or even temporarily stop production when prices are low and expected to rise. In some cases, they can increase production to take advantage of high prices.

Third, some wells move from one old production category to another every year. As an individual oil well's output declines over time, it will move into new categories as its daily production falls below thresholds of 15 and three barrels per day.

Finally, some wells cease production each year. As production from a well declines over time, its cost per unit of production rises, and eventually it becomes unprofitable. Some wells reach this point every year. In a year when prices are low and expected to remain low, more wells will be taken out of production than usual.

Annual production for each of the old production categories is estimated as a percentage of the previous year's production, which reflects declining production from individual wells already in the category and movement of wells *to* other categories; plus a percentage of the previous year's production in one or more other categories, which reflects wells moving *into* the category *from* other categories.

For example, in the category of stripper wells producing between three and 15 barrels per day, wells already in that category are producing less oil due to depletion, and some wells are moving out of this category into the category of wells producing less than three barrels per day. In addition, wells that previously had been producing more than 15 barrels per day are moving into this category.

Taxable Value

The gross value of production for each well category is calculated by multiplying production by the average price. The gross value is shared between working interest owners and royalty recipients. Working interest owners are partners in a production unit's operations. They pay a share of the costs and keep a share of the revenues. Royalty owners receive royalty payments based on production but do not share in operating costs. Royalty payments to the federal government and Indian tribes are not taxed.

Taxable value is then calculated for working interest owners and royalty owners. For each well category, the percentage of the gross value of production paid to working

interest owners, taxable royalty recipients, and tax-exempt royalty recipients was calculated for the period 2001 through 2003 from tax returns. Working interest owners received 85.3% of the gross value from oil wells. Taxable royalties were 11.1% of gross value, and exempt royalties were 3.6%. For natural gas wells, 84.5% of gross value went to working interest owners, 10.9% was paid in taxable royalties, and 4.6% was paid in exempt royalties. For each succeeding year, gross revenues were allocated to the three groups of recipients in the same proportions.

Table 4 Gross and Taxable Value of Oil and Natural Gas Production (\$ millions)					
Fiscal Year	Product	Gross Value	Taxable Value		
			Working Interest	Taxable Royalty	Exempt Royalty
A 2003	Oil	\$480.496	\$409.848	\$53.578	\$17.078
A 2004	Oil	\$624.483	\$532.812	\$73.533	\$20.708
F 2005	Oil	\$1,065.169	\$907.416	\$121.773	\$35.981
F 2006	Oil	\$1,053.781	\$897.539	\$121.347	\$34.895
F 2007	Oil	\$1,088.393	\$927.002	\$125.580	\$35.812

A 2003	Gas	\$256.604	\$217.416	\$27.414	\$11.870
A 2004	Gas	\$342.904	\$291.338	\$35.591	\$16.244
F 2005	Gas	\$496.941	\$418.918	\$55.937	\$22.086
F 2006	Gas	\$521.025	\$438.834	\$59.338	\$22.853
F 2007	Gas	\$505.294	\$425.312	\$58.033	\$21.948

Table 4 shows the allocation of gross value to working interests and royalty recipients. The projected gross value of oil production to increase in FY 2005, decrease slightly in FY 2006, and increase in FY 2007. The gross value of gas production is projected to increase in FY 2005 and FY 2006, and then decline slightly in FY 2007.

Tax Liability

Table 5 shows tax rates for oil and gas production. For tax purposes, there are 14 categories of oil production and six categories of natural gas production. Oil and gas tax rates are in two parts, a base rate and an additional rate to fund the Board of Oil and Gas Conservation. The Board reduced its rate from 0.3% to 0.26% on July 1, 2001.

Table 5 Oil and Natural Gas Tax Rates			
Product	Well Category	Working Interest	Royalties
Oil	New Vertical 0-12 Months	0.76%	15.06%
	Post 99 Regular	9.26%	15.06%
	Pre 99 Regular	12.76%	15.06%
	Stripper	5.76%	15.06%
	Stripper 10-15 Bbl/D	9.26%	15.06%
	Stripper Exemption	0.76%	15.06%
	Horizontal 0-18 Months	0.76%	15.06%
	Pre 99 Horizontal	12.76%	15.06%
	Post 99 Horizontal	9.26%	15.06%
	Horizontal Recomp 0-18 Months	5.76%	15.06%
	Pre 99 Horizontal Recompleted	12.76%	15.06%
	Post 99 Horizontal Recompleted	9.26%	15.06%
	Incremental Secondary	8.76%	15.06%
	Incremental Tertiary	6.06%	15.06%
Gas	New Vertical 0-12 Months	0.76%	15.06%
	Post 99 Regular	9.26%	15.06%
	Pre 99 Regular	15.06%	15.06%
	Pre 99 Stripper	11.26%	15.06%
	Horizontal 0-18 Months	0.76%	15.06%
	Horizontal Regular	9.26%	15.06%

Royalties are taxed at a rate of 15.06% regardless of the type of well. Working interest rates depend on the type of well and its age. Wells with higher costs or where production is more sensitive to cost are taxed at rates lower than regular production. New production is taxed at the lowest rates.

In any quarter when the average price of West Texas Intermediate is greater than \$30, the two incremental oil production categories and oil production from stripper wells producing more than three barrels per day are taxed as regular production. If the average price of West Texas Intermediate is greater than \$38 for a quarter, oil from stripper wells producing three barrels per day or less (stripper exemption) is taxed as regular production. The price of West Texas Intermediate is expected to be above \$38 through FY 2007.

Tax liability for working interest owners and royalty owners is estimated for each production category by multiplying the projected taxable value by the tax rate. Table 6 shows the average tax rates for oil and natural gas and taxes for each fiscal year from FY 2003 through FY 2007.

Table 6 Average Tax Rates and Taxes FY 2003 through FY 2007							
Fiscal Year	Product	-----Working Interest-----			-----Royalties-----		
		Taxable Value (\$ millions)	Average Tax Rate	Tax (\$ millions)	Taxable Value (\$ millions)	Average Tax Rate	Tax (\$ millions)
A 2003	Oil	\$409.848	8.12%	\$33.270	\$53.578	15.06%	\$8.069
A 2004	Oil	\$532.812	6.93%	\$36.925	\$73.533	14.71%	\$10.817
F 2005	Oil	\$907.416	8.14%	\$73.863	\$121.773	15.06%	\$18.339
F 2006	Oil	\$897.539	8.10%	\$72.666	\$121.347	15.06%	\$18.275
F 2007	Oil	\$927.002	8.11%	\$75.161	\$125.580	15.06%	\$18.912

A 2003	Gas	\$217.416	9.65%	\$20.983	\$27.414	15.06%	\$4.129
A 2004	Gas	\$291.338	8.79%	\$25.609	\$35.591	15.06%	\$5.360
F 2005	Gas	\$418.918	8.26%	\$34.618	\$55.937	15.06%	\$8.424
F 2006	Gas	\$438.834	8.18%	\$35.892	\$59.338	15.06%	\$8.936
F 2007	Gas	\$425.312	8.12%	\$34.533	\$58.033	15.06%	\$8.740

The average tax rates for working interests varies slightly from year to year as the proportion of production from each category of well changes. Taxes on oil are projected to increase over 90% in FY 2005, but remain steady in FY 2006 and FY 2007. Taxes on natural gas are projected to increase almost 40% in FY 2005 and then stabilize.

Allocation of Tax to General Fund

HB 748 passed by the 2003 legislature simplified the distribution of oil and gas tax. The Board of Oil and Gas Conservation receives the revenue raised by the 0.26% tax. The remaining revenue is divided in fixed proportions between the state and the county where the oil or natural gas was produced. The county percentage differs across counties and is based on the actual distribution under the old formula. The county share is allocated among the county, school districts, and countywide school funds in fixed proportions.

Fixed percentages of the state share are allocated to the coal bed methane protection account, the reclamation and development grants account, the orphan share account, and the university system. The remainder is deposited in the general fund.

Table 7 shows allocation percentages of the state's share of the oil and natural gas tax. HB 10 passed by the 2002 special session temporarily reallocated all but \$400,000 of oil and natural gas tax going for resource indemnity to the general fund. This reallocation was for FY 2003 only, and the percentages shown in Table 7 apply beginning in FY 2004.

Table 7	
Allocation of Oil and Natural Gas Revenues	
<u>Entity</u>	<u>Share of Tax</u>
Board of Oil and Gas Conservation	amount collected from 0.26% tax
Counties for County Government and Schools	fixed percentage for each county, average 49.8%
Coal Bed Methane Protection Account	1.23% of remainder after county allocation
Reclamation and Development Grants Account	2.95% of remainder after county allocation
Orphan Share Account	2.95% of remainder after county allocation
University System	2.65% of remainder after county allocation
General Fund	remainder (42.9% on average)

Table 8 shows total tax collections and the allocation of revenue for FY 2004 through FY 2007.

Table 8 Projected Oil and Natural Gas Tax Revenue by Fund (\$ millions)				
Entity	FY 2004	FY 2005	FY 2006	FY 2007
Board of Oil and Gas Conservation	\$1.906	\$3.911	\$3.944	\$3.993
Counties for County Government and Schools	\$44.964	\$66.719	\$66.978	\$67.756
Coal Bed Methane Protection Account	\$0.563	\$0.795	\$0.798	\$0.807
Reclamation and Development Grants Account	\$1.352	\$1.906	\$1.913	\$1.935
Orphan Share Account	\$1.352	\$1.906	\$1.913	\$1.935
University System	\$1.214	\$1.712	\$1.718	\$1.738
General Fund	\$41.324	\$58.296	\$58.505	\$59.182
Total	<u>\$92.676</u>	<u>\$135.244</u>	<u>\$135.770</u>	<u>\$137.347</u>

Oil and natural gas revenue allocated to these entities is projected to increase substantially in FY 2005. This increase is due primarily to the projected increase in oil and gas prices and secondarily to projected increases in production. Allocations are projected to increase slightly through FY 2007 for all accounts.

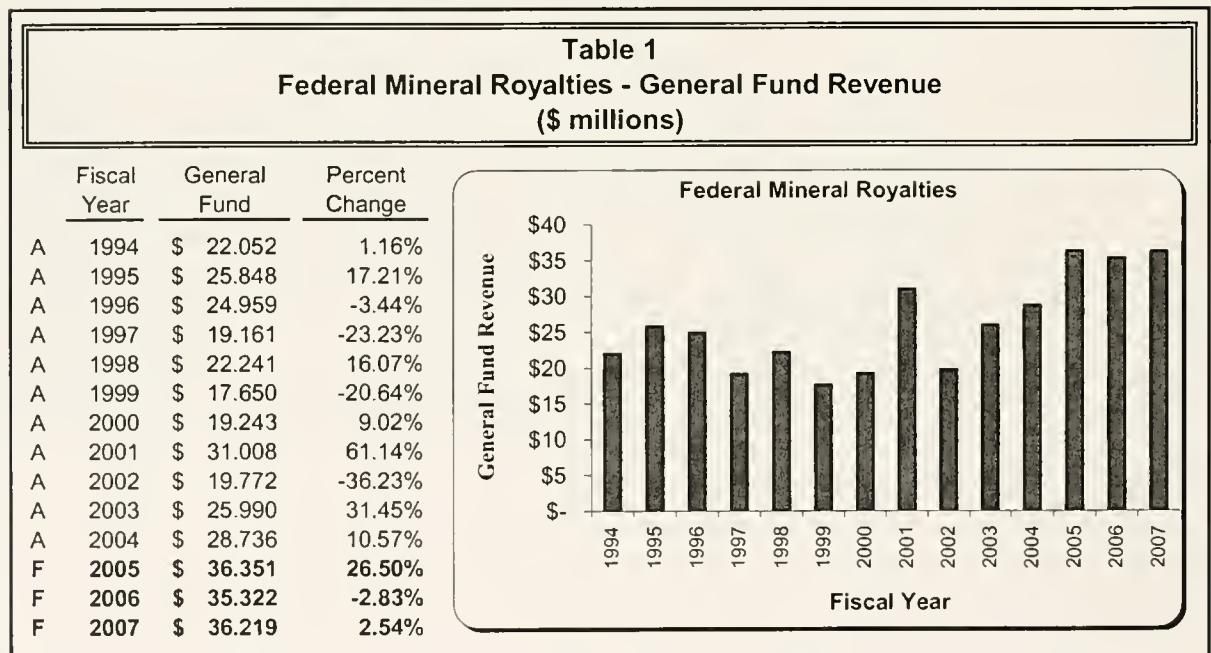
U. S. MINERAL ROYALTIES

Revenue Description

When the United States government leases public lands for mineral production, it pays part of the income to the state where the leased land is located. Montana receives a share of the revenue from coal, oil, and natural gas production on federal lands in the state. All payments to the state for mineral leases on federal land in Montana are deposited in the general fund. Following the close of the fiscal year, a share of the revenue is distributed to the counties where the royalties were earned. In FY 2004, 12.5% of the receipts were distributed to the counties. Beginning in FY 2005, 25% of the receipts will go to the counties.

Historical and Projected Revenue

Table 1 shows actual U.S. mineral royalty payments to Montana for FY 1994 through FY 2004, and projected payments for FY 2005 through FY 2007.



Receipts in FY 2001 include approximately \$8 million in payments for production in previous years that was collected due to audits. Without these audit collections, receipts would have been approximately \$23 million. Receipts in FY 2002 should have been higher, but the Minerals Management Service paid \$1.7 million of royalties late. This amount was recorded in the state accounting system as an adjustment to the general fund ending balance rather than as revenue.

Actual FY 2004 revenue is \$30 million (\$28.736 recorded in SABHRS plus \$1.286 million from a SABHRS underestimate of fourth quarter accrual). The expected revenue shown in Table 1 for FY 2005 is \$7.6 million or 26.5% higher than SABHRS revenue in FY 2004, but, after adjusting SABHRS revenue for the accrual variance, expected FY 2005 revenue is only \$6.3 million or 21% higher than actual FY 2004 revenue. This increase is primarily due to expected increases in production and price for oil, natural gas, and natural gas liquids.

Forecast Methodology and Projection Calculation

There are five steps to estimating revenues from federal mineral royalties:

1. Determining the revenue categories which comprise the FY 2004 U.S. mineral royalty payments;
2. Estimating mineral production;
3. Estimating mineral prices;
4. Adjusting the FY 2004 U.S. mineral royalty payments by the production and price changes; and
5. Estimating rents, bonuses and other payments.

FY 2004 Revenue Base for U.S. Mineral Royalty Payments

The Minerals Management Service distributes revenues to the states the month after the federal government receives it. During a fiscal year, the state receives payments for production in the first ten months of the fiscal year. At the end of the fiscal year, payments due for production in May and June are estimated and accrued. The detailed information available from the Minerals Management Service for the Montana FY 2004 payments is shown in Table 2.

Table 2 Federal Mineral Royalty Payments to Montana Production During FY 2004 (\$ millions)						
Coal Royalties	Natural Gas Royalties	Natural Gas Liquids Royalties	Oil Royalties	Rents	Bonus and Other	Total Payments
\$15.843	\$5.268	\$0.199	\$5.710	\$0.684	\$2.288	\$29.993

Mineral Production

Coal companies operating in Montana provided estimates of their coal production through 2007, and the portion of production they expected to occur on federal land. A

coal company's production varies from year to year according to the their long-term contracts and logistics. The fraction of a company's production that is on federal land varies from year to year because of the checkerboard ownership of mineral rights.

Based on information from the Minerals Management Service, federal coal production declined almost 12% in FY 2003 and 3% in FY 2004. Based on the survey information, federal coal production is projected to increase slightly in FY 2005, decrease 4% in FY 2006, and then increase 8% in FY 2007.

Natural gas, natural gas liquids, and oil production on federal lands in FY 2005 through FY 2007 was estimated by applying the growth rates for total production in the state used in the oil and gas tax forecast to the estimated federal production for FY 2004. Natural gas and natural gas liquids production is forecast to increase 12% in FY 2005, 9% in FY 2006, and 7% in FY 2007. Oil production is expected to increase 19% in FY 2005, 14% in FY 2006, and 11% in FY 2007.

Table 3 shows the annual percent change projected for coal, natural gas, natural gas liquids, and oil production on federal lands in Montana for FY 2005 through FY 2007.

Table 3 Annual Percent Change for Mineral Production on Federal Land in Montana FY 2005 through FY 2007				
Fiscal Year	Coal	Natural Gas	Natural Gas Liquids	Oil
F 2005	2.26%	12.37%	12.37%	18.67%
F 2006	-3.82%	9.41%	9.41%	14.29%
F 2007	8.29%	7.35%	7.35%	10.62%

Mineral Prices

Coal prices were estimated by applying Global Insight's October 2004 forecast of annual percentage changes in national average coal prices to prices of each mine obtained from the last year of coal severance tax returns and making one adjustment for information obtained from discussion with a coal company. Individual mines receive different prices because of differences in the quality of their coal in transportation costs. For FY 2005 through FY 2007, the federal mine price was assumed to change at the same rate as the weighted average coal severance tax mine price.

Prices for natural gas and oil for FY 2005 through FY 2007 were estimated by applying the same average percentage change in spot and futures market prices as used in the combined oil and natural gas revenue estimate. The natural gas liquids price was obtained from spot and future market prices.

Table 4 shows the annual percent price change forecast for coal, natural gas, natural gas liquids, and oil produced on federal lands in Montana for FY 2005 through FY 2007.

Table 4 Annual Percent Change for Montana Mineral Prices FY 2005 through FY 2007				
Fiscal Year	Coal	Natural Gas	Natural Gas Liquids	Oil
F 2005	-3.21%	28.96%	44.05%	43.74%
F 2006	-4.65%	-4.17%	-7.15%	-13.44%
F 2007	-2.53%	-9.66%	0.00%	-6.63%

Substantial increases are expected for prices of natural gas, natural gas liquids, and oil in FY 2005. These expected increases in price correspond with expected increases in production to generate the large increase in general fund revenue for FY 2005 seen in Table 1.

Change in Mineral Royalty Payments

The mineral royalty payments to Montana are forecast to increase by the annual percent change that the combined production (Table 3) and price changes (Table 4) produce. Table 5 shows the annual percent change expected by mineral and by fiscal year for the U.S. mineral royalty payments. As shown in Table 5, coal royalties are expected to decrease in FY 2005 and FY 2006 and then increase in FY 2007. Natural gas, natural gas liquids, and oil are expected to increase substantially in FY 2005 and vary some in FY 2006 and FY 2007, but not have the dramatic change that FY 2005 does.

Table 5 Annual Percent Change for Federal Mineral Royalties FY 2005 through FY 2007				
Fiscal Year	Coal	Natural Gas	Natural Gas Liquids	Oil
F 2005	-1.02%	44.92%	61.87%	70.57%
F 2006	-8.29%	4.85%	1.59%	-1.07%
F 2007	5.55%	-3.02%	7.35%	3.28%

Rents, Bonuses, and Other Revenue

Rents are annual payments on leases not currently under production made to retain rights to the leases. Federal oil and natural gas leases generally have a term of five years, which will be extended if the leaseholder demonstrates that it contains commercially producible reserves. Coal leases have terms of at least 20 years, and can be extended as long as production continues. Some lease agreements specify that rent payments continue for the life of the lease, while others do not require rent payments from leases that are paying royalties. The state share of rents is forecast to remain at \$684,000, the FY 2004 level, for FY 2005 through FY 2007.

Bonuses are payments made to obtain the rights to mineral leases. The bonuses that producers pay to obtain mineral leases in any year depend on the acreage offered for bids, producers' expectations of future mineral prices, producers' beliefs about the size and quality of deposits on particular lease tracts, and the ease or difficulty of getting financing for mineral exploration and development. Because all of these factors vary from year to year, bonus payments may show great variation.

Other royalties include royalties on sand and gravel, sulfur, carbon dioxide and other minor products plus payments resulting from audits of previous years' production and royalties. It also includes some payments not directly related to mineral production, such as pipeline right-of-way fees. The Department of Revenue audits royalty collections on federal land in Montana, with the Minerals Management Service paying the full cost. Audit revenues typically vary greatly from year to year, following no particular pattern. Because of this lack of pattern, the state share of bonuses and other revenues is forecast to continue at the FY 2004 level of \$2.288 million through FY 2007.

Payments to Counties

Federal law requires that a portion of mineral royalties go to the counties where mineral production occurred. The 2001 Legislature passed HB 226 to comply with this federal requirement. For FY 2002 and FY 2003, royalties in excess of the HJR 2 revenue estimates were allocated to the counties where mineral production occurred. In FY 2004, 12.5% of U.S. mineral revenues were allocated to the counties. Beginning in FY 2005, 25% will be allocated to the counties each year.

Summary of U.S. Mineral Royalty Revenues

The SABHRS number for U.S. mineral royalty payments is \$28.736 million. When the SABHRS number is adjusted to actual revenue for FY 2004 it would be \$30.022 million. The federal data by mineral and other revenue categories shows a Montana revenue base of \$30 million for FY 2004.

Table 6 shows the FY 2004 revenue base of \$29.993 that was used in the revenue estimate and the table gives the annual state share of federal mineral royalties revenue by type and the county payments for FY 2005 through FY 2007. It is forecast that U.S. mineral royalty payments will be \$36.351 million in FY 2005, \$35.322 million in FY 2006, and \$36.219 million in FY 2007. The state share in FY 2005 is forecast to be 21% higher than FY 2004 actual revenue due primarily to forecast increases in production and price for oil, natural gas, and natural gas liquids.

Table 6 Receipts from Federal Mineral Royalties (\$ millions)				
Revenue Type	FY 2004	FY 2005	FY 2006	FY 2007
Coal Royalties	\$15.843	\$15.681	\$14.381	\$15.179
Gas Royalties	\$5.268	\$7.635	\$8.005	\$7.763
NGL Royalties	\$0.199	\$0.322	\$0.328	\$0.352
Oil Royalties	\$5.710	\$9.740	\$9.636	\$9.952
Rents	\$0.684	\$0.684	\$0.684	\$0.684
Bonus and Other	\$2.288	\$2.288	\$2.288	\$2.288
Total	<u>\$29.993</u>	<u>\$36.351</u>	<u>\$35.322</u>	<u>\$36.219</u>
County Distribution	\$3.502	\$9.088	\$8.830	\$9.055

COAL SEVERANCE TAX

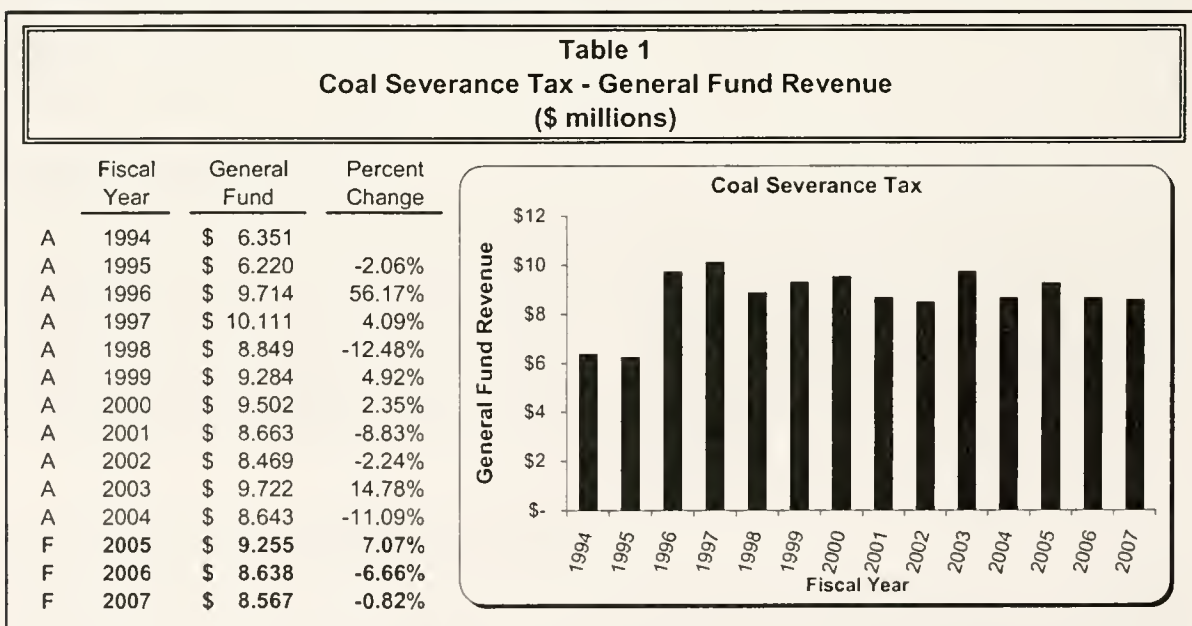
Revenue Description

Coal mines in Montana pay a severance tax based on the value of coal produced (15-35-103, MCA). The tax rate on coal from surface mines is 10% if the heat content is less than 7,000 British thermal units (Btu) per pound and 15% if the heat content is at least 7,000 Btu per pound. The tax rates for coal from underground mines are 3% for coal with less than 7,000 Btu per pound and 4% for coal with more than 7,000 Btu per pound. Each producer is exempt from tax on 20,000 tons per year, and mines producing less than 50,000 tons per year are exempt from the tax. The first two million tons of coal used as feedstock in a coal enhancement facility is exempt from the tax.

Coal severance taxes are distributed to several accounts. In FY 2000 through FY 2002, the general fund received 26.79% of coal severance tax revenues. HB 10 and HB 18 passed by the 2002 special session temporarily increased the general fund allocation to 33.04% for FY 2003 and set it at 27.4% beginning in FY 2004.

Historical and Projected Revenue

Table 1 shows actual coal severance tax general fund collections through FY 2004 and projected collections for FY 2005 through FY 2007.



The general fund figure for FY 2004 in the table is a SABHRS number that underestimates actual general fund revenue from the coal severance tax by about \$740,000. This is due to under estimating the fourth quarter coal tax, which is accrued

at fiscal year end by \$2.7 million ($\$2.7 \times 27.4\% = \$740,000$). Thus, the projected change from FY 2004 to FY 2005 is a 1.3% decrease rather than the 7.1% increase indicated in Table 1. Coal severance tax general fund collections are projected to decrease 6.7% in FY 2006 and 0.8% in FY 2007. This decrease is primarily due to projected decreases in the price for coal.

Forecast Methodology and Projection Calculation

There are five steps to estimating general fund revenue from the coal severance tax: 1) estimating production; 2) estimating prices; 3) determining taxable value; 4) calculating total tax collections; and 5) allocating tax collections to the various funds.

Coal Production

In the fall of 2004, the budget office surveyed coal producers in Montana about their expectations of production through 2007. Results of this survey and recent news reports were used to forecast production. At this time, there is considerable uncertainty about coal production. Several long-term contracts have recently expired. Because of this, one mine has closed and another has reduced its output. At the same time, one existing mine is expanding production, and a new mine has started production on a small scale with plans for expansion. This forecast assumes that new customers will not be found to replace the contracts that have been lost and that the new mine will not have significant production until after FY 2007.

Taxable production is total production minus exemptions. Each producer is allowed to deduct 20,000 tons from total production per calendar year. If a mine produces less than 50,000 tons, all of this production is exempt. In addition to this exemption, producers are allowed to deduct up to two million tons of coal produced as feedstock for coal enhancement facilities. Table 2 shows coal production, exemptions, and taxable production.

Production decreased steadily through FY 2003, then increased about 1.6 million tons in FY 2004, and is forecast to be above 32.1 million tons a year through FY 2007. The five producers each are expected to exempt 20,000 tons. Feedstock exemptions are forecast to be zero.

Table 2
Calculation of Taxable Coal Production
(million tons)

Fiscal Year	Total Production	20,000 T/mine Exemption	Feedstock Use Exemption	Taxable Production
A 1998	35.860	- 0.100	- 0.259	= 35.501
A 1999	35.191	- 0.100	- 0.116	= 34.975
A 2000	35.257	- 0.100	- 1.482	= 33.675
A 2001	32.733	- 0.073	- 0.342	= 32.318
A 2002	33.259	- 0.110	- 0.000	= 33.149
A 2003	30.346	- 0.100	- 0.000	= 30.246
A 2004	31.927	- 0.093	- 0.000	= 31.834
F 2005	33.013	- 0.100	- 0.000	= 32.913
F 2006	32.215	- 0.100	- 0.000	= 32.115
F 2007	32.758	- 0.100	- 0.000	= 32.658

Coal Price and Taxable Value

The contract sales price excludes taxes and state, federal, and Indian royalties of more than 15 cents per ton. From 1996 through 2004, the average contract sales price of Montana coal has moved in the same direction as the national average price, but has shown larger relative movements.

Future contract sales prices for each company were estimated by applying Global Insight's forecast of annual percentage changes in the national average coal price to each company's actual contract sales price for the last quarter. The average contract sales price is projected to decrease in FY 2005 and again in FY 2006 primarily because the expiring long-term contracts had higher prices than contracts that will continue through the period.

Taxable value is the product of taxable production and contract sales price. Table 3 shows taxable production, average contract sales price, and the taxable value of coal production.

The average contract sales price decreases in all three years of the forecast. Taxable production is forecast to increase in FY 2005, decrease in FY 2006, then increase in FY 2007 due to the timing of when some mines' production declines and other mines' production increases.

Table 3
Taxable Value of Coal Production

Fiscal Year	Taxable Production (million tons)		Average Contract Sales Price (\$/ton)		Taxable Value (\$ millions)	Percent Change
A 1998	35.501	x	\$6.776	=	\$240.554	
A 1999	34.975	x	\$5.995	=	\$209.692	-12.83%
A 2000	33.675	x	\$6.723	=	\$226.388	7.96%
A 2001	32.318	x	\$6.231	=	\$201.362	-11.05%
A 2002	33.149	x	\$6.380	=	\$211.487	5.03%
A 2003	30.246	x	\$6.596	=	\$199.490	-5.67%
A 2004	31.834	x	\$7.218	=	\$229.792	15.19%
F 2005	32.913	x	\$6.922	=	\$227.842	-0.85%
F 2006	32.115	x	\$6.628	=	\$212.868	-6.57%
F 2007	32.658	x	\$6.466	=	\$211.161	-0.80%

Calculating Coal Severance Tax Collections

Most coal production is taxed at 15%, but about 1% is low energy-content coal, which is taxed at 10%. Underground coal production is taxed at 4% of taxable value. Underground production is expected to be a minor component of production in FY 2005, FY 2006, and FY 2007. The overall coal tax rate is projected to be 14.82% in FY 2005, and 14.81% in both FY 2006 and FY 2007. The forecast assumes that collections will equal liability in future years. Collections recorded on the state accounting system for a single year may be higher or lower than tax liability for that fiscal year because an estimate of taxes due for the last quarter is accrued at fiscal year end. However, collections and liability balance over a longer time span.

The coal severance tax is forecast by multiplying taxable value by the severance tax rate, as shown in Table 4.

The second column of the table shows total taxable value. The third column shows the average tax rate. The fourth column shows coal severance tax liability. The last column shows annual change in tax liability.

Table 4 Coal Severance Tax Liability (\$ millions)				
Fiscal Year	Taxable Value	Average Tax Rate	Tax Liability	Percent Change
A 1998	\$240.554	x 14.96%	= \$35.976	
A 1999	\$209.692	x 14.94%	= \$31.328	-12.92%
A 2000	\$226.388	x 14.94%	= \$33.821	7.96%
A 2001	\$201.362	x 14.95%	= \$30.100	-11.00%
A 2002	\$211.487	x 14.94%	= \$31.594	4.96%
A 2003	\$199.490	x 14.92%	= \$29.766	-5.79%
A 2004	\$229.792	x 14.90%	= \$34.230	15.00%
F 2005	\$227.842	x 14.82%	= \$33.776	-1.33%
F 2006	\$212.868	x 14.81%	= \$31.526	-6.66%
F 2007	\$211.161	x 14.81%	= \$31.268	-0.82%

Coal Severance Tax Allocation

Table 5 shows the statutory allocation of the coal severance tax revenue. HB 10 and HB 18 passed by the 2002 special session increased the general fund to 33.04% for FY 2003. Beginning with FY 2004, the general fund share is 27.40% of collections.

Table 5 Allocation of Coal Severance Tax Revenues Fiscal Years 2005 through 2007	
Account	Percent Allocation
Coal Tax Trust Fund	50.00%
Long Range Building Program Account	12.00%
Local Impacts	7.75%
Parks Trust Fund	1.27%
Renewable Resource Loan Debt Service Fund	0.95%
Capitol Art Protection Trust Fund	0.63%
General Fund	27.40%
	<u>100.00%</u>

Table 6 shows the coal severance tax allocation for FY 2004 through FY 2007. The difference between the SABHRS FY 2004 total tax and the actual FY 2004 tax is the underestimate of the \$2.7 million accrual.

Table 6 Coal Severance Tax Allocation by Fund (\$ millions)					
Account	SABHRS FY 2004	Actual FY 2004	FY 2005	FY 2006	FY 2007
Coal Tax Trust Fund	\$15.772	\$17.115	\$16.888	\$15.763	\$15.634
Long Range Building Program Account	\$3.785	\$4.108	\$4.053	\$3.783	\$3.752
Local Impacts	\$2.445	\$2.653	\$2.618	\$2.443	\$2.423
Parks Trust Fund	\$0.401	\$0.435	\$0.429	\$0.400	\$0.397
Renewable Resource Loan Debt Service Fund	\$0.300	\$0.325	\$0.321	\$0.299	\$0.297
Capitol Art Protection Trust Fund	\$0.199	\$0.216	\$0.213	\$0.199	\$0.197
General Fund	\$8.643	\$9.379	\$9.255	\$8.638	\$8.567
Total Coal Severance Tax	<u>\$31.545</u>	<u>\$34.230</u>	<u>\$33.776</u>	<u>\$31.526</u>	<u>\$31.268</u>

METALLIFEROUS MINES LICENSE TAX

Revenue Description

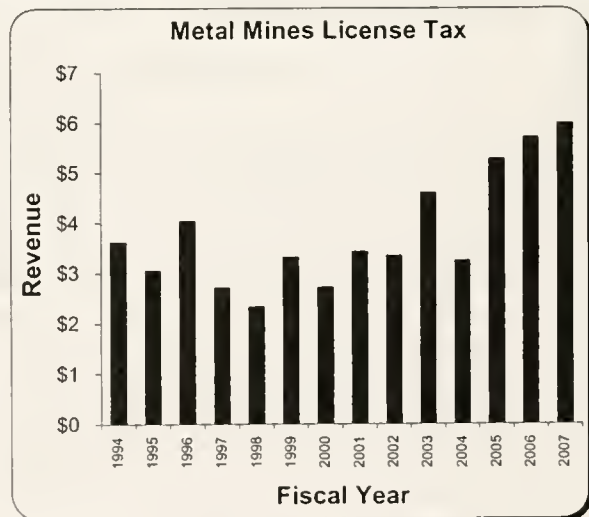
Montana taxes the gross value of metals mined in the state (15-37-101, MCA). Gross value is the market value of the refined product, less the costs of transporting the unrefined product to a smelter or other facility and refining it (15-23-801, MCA). The first \$250,000 of gross value is exempt from the tax, which essentially exempts smaller mines. The tax rate for production beyond \$250,000 depends on the mineral and the amount of processing at the mine. Concentrate, which is unsmelted ore that may have undergone mechanical processing, is taxed at 1.81%. Gold, silver, and platinum-group metals that have been partially or completely separated from impurities by smelting, but may not have had the individual metals separated, are taxed at 1.6% (15-37-103, MCA).

Revenues from the metalliferous mines license tax are divided between the state and counties where a mine is located or which have economic impacts from large-scale mining. The state general fund receives 58% of the revenue except in FY 2003, when the state received 65%.

Historical and Projected Revenue

Table 1 shows actual general fund receipts for FY 1994 through FY 2004 and projected collections for FY 2005 through FY 2007.

Table 1 Metalliferous Mines License Tax (\$ millions)			
Fiscal Year	Collections	General Fund	Percent Change
A 1994	\$6.230	\$3.610	-10.4%
A 1995	\$5.259	\$3.050	-15.5%
A 1996	\$6.941	\$4.030	32.1%
A 1997	\$4.649	\$2.696	-33.1%
A 1998	\$3.978	\$2.319	-14.0%
A 1999	\$5.711	\$3.305	42.5%
A 2000	\$4.661	\$2.703	-18.2%
A 2001	\$5.924	\$3.417	26.4%
A 2002	\$5.740	\$3.329	-2.6%
A 2003	\$7.056	\$4.586	37.8%
A 2004	\$5.572	\$3.232	-29.5%
F 2005	\$9.064	\$5.257	62.7%
F 2006	\$9.820	\$5.696	8.3%
F 2007	\$10.302	\$5.975	4.9%



Revenue has varied from year to year because of a change in the tax due date and changes in production and prices. Through December 31, 2002, the tax was paid annually. Beginning January 1, 2003, the tax is paid semiannually. This resulted in taxes on eighteen months of production being recorded as revenue in FY 2003.

The general fund portion of this revenue was higher in FY 2003 due to the change in the timing of payments and because 7% of the revenue that normally goes to reclamation and development grants went to the general fund in FY 2003 only.

The Department of Revenue estimates tax due for the second half of the fiscal year and accrues this as revenue for the fiscal year. At the end of FY 2004, the department under estimated the tax due by \$0.770 million. Actual collections for production in FY 2004 were \$6.342 million. Revenue is projected to increase in FY 2005 through FY 2007 as mines that temporarily stopped production resume production. Several mines have closed and two new mines have opened.

Forecast Methodology and Projection Calculation

There are five steps to estimating metal mines license tax revenues: 1) estimating production of each metal; 2) estimating the price of each metal; 3) estimating the taxable value of production, which is gross value less deductions and exemptions; 4) determining the estimated tax by multiplying taxable value by the tax rate; and 5) allocating revenue between the general fund and other funds.

Revenue was estimated using detailed information on each metal produced by each mine. Since there are only four mines paying the metal mines license tax and they produce different metals, presenting detailed information on individual metals could reveal information about individual taxpayers. To avoid this, production and taxable value estimates are presented as totals for groups of metals. This shows general trends without revealing information about individual taxpayers.

Metal Production

Estimates of metal production were obtained from the mines. The active large-scale mines in Montana produce gold, platinum, palladium, copper and molybdenum as their primary products. The other metals may be considered by-products. Table 2 shows the projected annual production of gold, silver and platinum group metals and of all other metals.

Table 2 Projected Metal Production				
Metal	FY 2004	FY 2005	FY 2006	FY 2007
Gold, Silver, Platinum Group (million oz.)	1.673	2.521	2.190	2.265
Other Metals (million lb.)	78.021	124.426	145.951	152.406

Expected production for both metal groups is over 50% greater than actual production in FY 2004. Much of this increase is due to one mine that resumed production midway through FY 2004. Production from this mine in FY 2005 is expected to almost double from FY 2004. Production within the gold, silver and platinum group is projected to fall off 13% in FY 2006, but production within the other metals group is expected to increase 17% in FY 2006 and 4% in FY 2007.

Metal Prices

Most metals are traded on organized exchanges, and prices are public. The commodity exchanges also conduct trading in metal futures contracts. These contracts set a price now for metal to be delivered at a specified time and place in the future. The London Metals Exchange has futures trading in silver, copper, nickel, lead, and zinc. The New York Mercantile Exchange has futures trading in gold, silver, copper, platinum, and palladium.

Futures prices reflect producers', buyers', and traders' expectations of what prices will be in the future. On average, they are good predictors of prices up to several years ahead. Average October 2004 futures prices from the London Metals Exchange and New York Mercantile Exchange were used in the methodology to forecast prices for gold, silver, copper, platinum, palladium, nickel, lead, and zinc.

Futures contracts sold in October 2004 extend to FY 2007 for gold, silver, copper, nickel, and zinc, to FY 2006 for lead, and to FY 2005 for platinum and palladium. For those metals that do not have a future price through FY 2007, the futures price is assumed to hold steady through FY 2007 at an average of previous futures prices. There are no futures markets for rhodium and molybdenum; for these metals the last four months of the spot market is used.

Prices received by mines in Montana differ from the prices established in world markets because of transportation costs and contract terms. The forecast uses actual prices reported on FY 2004 tax returns as the starting point. It assumes that the differences between prices received by the mines and the central market prices will remain the same so that prices received by the mines will change by the same amount each year as the central market prices in New York and London. For example, the average expected New York/London price of gold is \$24.57 per ounce higher in FY 2005 than in FY 2004. Therefore, the price received for gold by a mine in FY 2005 is projected to be \$24.57 per ounce higher than the price the mine received in FY 2004.

Table 3 shows metal price forecasts for FY 2005 through FY 2007 for mines operating in Montana. Mine prices are not given for the platinum group and for molybdenum to ensure preservation of confidential information.

Table 3 Projected Metal Prices			
Metal	FY 2005	FY 2006	FY 2007
-----Adjusted Weighted Average Mine Price-----			
Gold (oz)	\$411.40	\$427.94	\$441.15
Silver (oz)	\$6.77	\$7.31	\$7.41
Copper (lbs)	\$1.22	\$1.08	\$0.99
Nickel (lbs)	\$6.10	\$4.98	\$4.22
Lead (lbs)	\$0.43	\$0.43	\$0.43
Zinc (lbs)	\$0.48	\$0.50	\$0.50
-----Spot/Futures Market Price-----			
Platinum (oz)	\$826.92	\$826.92	\$826.92
Palladium (oz)	\$224.93	\$224.93	\$224.93
Rhodium (oz)	\$1,095.08	\$1,095.08	\$1,095.08
Molybdenum (lbs)	\$16.11	\$16.11	\$16.11

Taxable Value of Production

The base for the metalliferous mines license tax is the gross value of output as it leaves the mine, less exemptions and deductions. The first \$250,000 of each producer's output is exempt from the tax. Producers are also allowed to deduct certain smelting and refining costs and the costs of transportation to the smelter or refinery.

Table 4 shows the calculation of taxable value. The values shown are the product of the detailed production estimates behind Table 2 and the mine prices in Table 3. The sum of these market values for all metals is shown in the row labeled Market Value. Taxable value is calculated by subtracting total exemptions and deductions from market value. Deductions for smelting, refining and transportation costs were estimated from the deductions claimed on past tax returns and the surveys with the mining companies.

Table 4 Taxable Value of Metal Mines Production (\$ millions)				
Metal	FY 2004	FY 2005	FY 2006	FY 2007
Gold, Silver, Platinum Group	\$315.047	\$328.200	\$393.503	\$430.328
Other Metals	103.464	232.038	231.592	226.572
Market Value	\$418.511	\$560.238	\$625.094	\$656.900
Exemptions and Deductions	-36.005	-40.851	-43.599	-44.854
Taxable Value	\$382.506	\$519.387	\$581.496	\$612.045

Calendar Year Tax Liability

Concentrate, which is unsmelted ore that may have undergone mechanical processing, is taxed at a rate of 1.81%. Gold, silver, and platinum-group metals that are sold as dore, bullion, or matte are taxed at a rate of 1.6%. Smelting the ore produces dore, bullion, and matte. In matte, the metal is still chemically combined with other elements. dore is a mixture of elemental metals. Bullion is pure metal.

Future tax liability is estimated by multiplying the taxable value of each form of each metal by the appropriate tax rate. Table 5 shows the total taxable value calculated in Table 4, the average tax rate, and the tax.

Table 5 Calculation of Metal Mines Tax Liability (\$ millions)				
	FY 2004	FY 2005	FY 2006	FY 2007
Taxable Value	\$382.506	\$519.387	\$581.496	\$612.045
Average Tax Rate	1.658%	1.745%	1.689%	1.683%
Tax Liability	\$6.342	\$9.064	\$9.820	\$10.302

Revenue Allocation

Table 6 shows the metal mines license tax, its allocation for FY 2004, and forecasts for FY 2005 through FY 2007. For clarity, the revenue recorded in SABHRS is shown as well as the actual metal mines tax collections for FY 2004. The SABHRS estimate of actual tax collections is \$770,000 less than actual collections due to an under accrual of revenue at fiscal year end.

Revenue is projected to increase from \$6.342 million in FY 2004 to \$9.064 in FY 2005, \$9.820 in FY 2006, and \$10.302 in FY 2007. The revenue increase is due to higher prices and production.

Table 6 Total Collections and Allocation of Metal Mines Tax (\$ millions)						
Account	Allocation Percent	SABHRS FY 2004	Actual FY 2004	-----Projected----- FY 2005	FY 2006	FY 2007
General Fund	58.0%	\$3.232	\$3.678	\$5.257	\$5.696	\$5.975
Hard-Rock Mining Impact Trust	2.5%	\$0.139	\$0.159	\$0.227	\$0.246	\$0.258
Service	8.5%	\$0.474	\$0.539	\$0.770	\$0.835	\$0.876
Reclamation and Development Grants	7.0%	\$0.390	\$0.444	\$0.634	\$0.687	\$0.721
Impacted Counties	24.0%	\$1.337	\$1.522	\$2.175	\$2.357	\$2.473
Total Collections	100.0%	\$5.572	\$6.342	\$9.064	\$9.820	\$10.302

ELECTRICAL ENERGY PRODUCERS' LICENSE TAX

Revenue Description

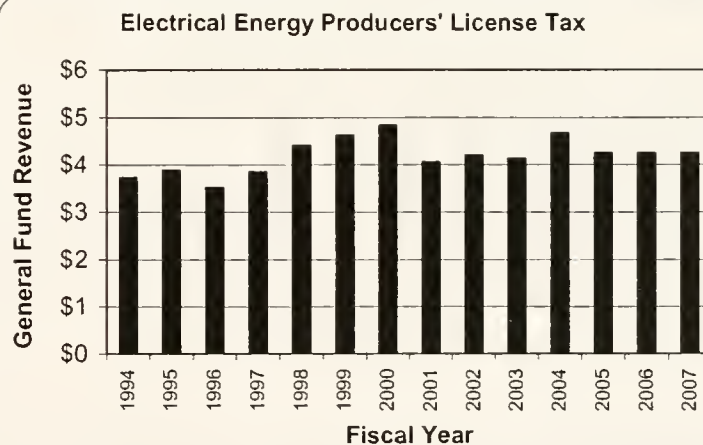
Title 15, chapter 51, MCA, provides for the imposition and collection of the electrical energy producers' license tax. Enacted in 1933, the tax currently is levied at a rate of \$.0002 per kilowatt-hour on all electricity generated, manufactured, or produced in Montana for barter, sale, or exchange other than for plant use. This tax is remitted 100% to the general fund.

Historical and Projected Revenue

Table 1 shows historical and forecast collections for the electrical energy producers' license tax for FY 1994 through FY 2007.

Table 1
Electrical Energy Producers' License Tax - General Fund Revenues
(\$ millions)

	Fiscal Year	General Fund	Percent Change
A	1994	\$3.728	-11.90%
A	1995	\$3.886	4.23%
A	1996	\$3.520	-9.41%
A	1997	\$3.849	9.34%
A	1998	\$4.402	14.36%
A	1999	\$4.618	4.92%
A	2000	\$4.829	4.56%
A	2001	\$4.058	-15.97%
A	2002	\$4.197	3.44%
A	2003	\$4.130	-1.61%
A	2004	\$4.661	12.86%
F	2005	\$4.243	-8.97%
F	2006	\$4.243	0.00%
F	2007	\$4.243	0.00%



Since FY 1994 the revenue from this tax has fluctuated. The SABHRS numbers are not always reflective of the actual tax due for a fiscal year because the fourth quarter of each fiscal year is accrued, and the accruals are not always precise. For example, in FY 2004 the SABHRS number is \$198,182 too high. Based on taxable kilowatt-hours, the electrical energy producers' license tax is forecast to decrease 1% in FY 2005, and remain constant in FY 2006 and FY 2007. A five-year average is used to project taxable kilowatt-hours into FY 2005, FY 2006, and FY 2007. The five-year average for taxable kilowatt-hours is approximately 1% less than FY 2004 taxable kilowatt-hours; this explains the estimated decrease from FY 2004 levels.

Forecast Methodology and Projected Calculation

The revenue estimate is made in three steps. The first step is projecting the taxable kilowatt-hours from the existing electrical generation facilities. The second step is projecting the taxable kilowatt-hours from new electrical generation facilities. The third step is multiplying the total taxable kilowatt-hours by the tax rate to get the projected tax revenue.

Over the FY 1994 to FY 2004 time period, this revenue has not had a consistent trend, fluctuating from year to year. Therefore, the appropriate forecasting technique is a "single moving average forecast" – a simple average of previous years. To choose the number of years used in the forecast, simulations were run each year from FY 1997 through FY 2004, and the accuracy of the simulations checked. Two year through five year moving average forecasts were evaluated. In all cases, the absolute percentage errors were similar, but the average absolute percentage error for the five-year moving average forecast was slightly lower, and therefore, it was chosen. The percentage errors over the simulated forecast period are in the last column of Table 2.

Table 2 Existing Electric Generation Taxable kWh (million)			
<u>Fiscal Year</u>	<u>Taxable kWh</u>	<u>5 Year Moving Avg. Forecast</u>	<u>% Error</u>
A 1994	19,838		
A 1995	21,079		
A 1996	18,443		
A 1997	20,160		
A 1998	22,015		
A 1999	22,265	20,307	-8.8%
A 2000	21,510	20,792	-3.3%
A 2001	20,444	20,878	2.1%
A 2002	21,643	21,279	-1.7%
A 2003	21,069	21,575	2.4%
A 2004	21,410	21,386	-0.1%
F 2005		21,215	
F 2006		21,215	
F 2007		21,215	
Absolute Average % Error			3.7%

New electrical generation facilities are in various stages of planning and/or construction in Montana. Whether or not they are built depends on a number of factors such as electricity prices and construction costs. No increased electrical generation kilowatt-hours are included in the revenue estimate.

Table 3 shows the taxable kilowatt-hours from both existing and new electrical generation facilities. The total estimated taxable kilowatt-hours are multiplied by the tax rate of \$.0002 per kilowatt-hour to calculate revenue projections of \$4.243 million in FY 2005, \$4.243 million in FY 2006, and \$4.243 million in FY 2007.

Table 3 Calculation of Electrical Energy Producers License Tax Forecast FY 2005 through FY 2007				
<u>Fiscal Year</u>	<u>kWh (millions)</u>		<u>Tax Rate Per Million kWh</u>	<u>Total Revenue</u>
F 2005	21,215	X	\$200	= \$4,243,019
F 2006	21,215	X	\$200	= \$4,243,019
F 2007	21,215	X	\$200	= \$4,243,019

WHOLESALE ENERGY TRANSACTION TAX

Revenue Description

Title 15, Chapter 72, MCA, provides for the imposition and collection of the wholesale energy transaction tax at a rate of 0.015 cents per kilowatt-hour (kWh) on electricity transmitted by a transmission service provider in the state. Power generated by the U.S. government is exempt. This tax was effective January 1, 2000 and is deposited 100% in the state general fund.

Historical and Projected Revenue

Table 1 shows actual and forecast wholesale energy transaction tax revenue for FY 2000 through FY 2007.

Table 1 Wholesale Energy Transaction Tax (\$ millions)			Wholesale Energy Transaction Tax Adjusted General Fund Revenues	
Fiscal Year	General Fund	Percent Change		
A 2000	\$1.895			
A 2001	\$3.503	84.9%		
A 2002	\$2.906	-17.0%		
A 2003	\$3.532	21.5%		
A 2004	\$3.293	-6.8%		
F 2005	\$3.485	5.8%		
F 2006	\$3.520	1.0%		
F 2007	\$3.555	1.0%		

Revenue growth has been highly variable. Growth of taxable kilowatt-hours, shown in Table 3 on the next page, has had more consistent growth. Several items account for this difference:

- FY 2000 revenue is only a half-year amount, and the accrual was \$189,611 high.
- In FY 2001, the fiscal year-end estimated accrual was \$174,357 too low, there was a tax overpayment of \$425,801, and there was approximately \$42,000 in miscellaneous adjustments.
- In FY 2002 a refund of \$425,801 was made for the overpayment in FY 2001.
- The FY 2003 accrual was \$69,000 too low.
- In FY 2004, there was a revenue adjustment, which reduced FY 2004 revenue by \$236,000 in SABHRS to account for a revised report on FY 2003 kilowatt-hour production, and the FY 2004 fiscal year-end accrual was \$109,247 too high.

When the aforementioned adjustments are removed from actual collections, a more stable amount of revenue was collected each year. Based on the estimated growth in taxable kilowatt-hours, revenue is expected to remain constant for FY 2005, and then grow 1% a year in FY 2006 and FY 2007.

Forecast Methodology and Projected Calculation

There are two steps to estimating the wholesale energy transaction tax: estimating the taxable kilowatt-hours, and calculating the tax.

Historical Taxable Kilowatt Hours

Only four years of fiscal year data are available as this tax was established in January 2000. A time series this short does not lend itself to a statistically reliable trend indicator, although the taxable kilowatt-hours in Table 3 show consistent growth from FY 2001 through FY 2004. The average annual growth is 2.1%.

Table 3 Taxable Kilowatt-Hours for Wholesale Energy Tax FY 2000 through FY 2004						
Fiscal Year	Quarter 1 July - Sept.	Quarter 2 Oct. - Dec.	Quarter 3 Jan.- March	Quarter 4 April - June	Fiscal Year Total	% Change
2000	-----0-----	-----0-----	6,616,241,959	5,284,198,270	11,900,440,229	
2001	5,419,469,746	5,943,776,467	5,696,989,674	4,870,218,101	21,930,453,988	NA
2002	5,691,480,747	5,647,275,070	5,162,383,799	5,576,221,735	22,077,361,351	0.67%
2003	5,686,251,696	5,460,463,017	5,828,994,674	5,498,883,622	22,474,593,009	1.80%
2004	6,169,847,022	5,830,473,451	5,889,521,188	5,346,097,294	23,235,938,955	3.39%

New electrical power generation facilities may begin production in Montana and increase the state's production capability. This may be an indicator of increased sales, although not necessarily.

The first two quarters of calendar year 2004 are 0.81% less than the first two quarters of calendar year 2003, and it appears that some producers will have a reduced third quarter also. Therefore the growth rate for FY 2005 is held constant at the FY 2004 level. Based on a survey and discussions with company officials a 1% growth rate is used to estimate FY 2006 and FY 2007 kilowatt-hours.

Calculation of Project Revenue

Table 4 shows the tax calculation based on the projected taxable kilowatt-hours for FY 2005 through FY 2007. Wholesale energy transaction tax revenue is estimated at \$3.485 million in FY 2005, \$3.520 million in FY 2006, and \$3.555 million in FY 2007.

Table 4 Wholesale Energy Transaction Tax General Fund Revenue									
Fiscal Year	Base Taxable kWh	X	Growth Rate	=	Estimated Kilowatt Hours	X	Tax Rate	=	General Fund
A 2004	23,235,938,955	X				X		=	
F 2005	23,235,938,955	X	0.0%	=	23,235,938,955	X	\$0.00015	=	\$3,485,391
F 2006	23,235,938,955	X	1.0%	=	23,468,298,345	X	\$0.00015	=	\$3,520,245
F 2007	23,468,298,345	X	1.0%	=	23,702,981,328	X	\$0.00015	=	\$3,555,447

INTEREST EARNINGS INTRODUCTION

Revenue Description

The state earns interest on several trust funds and on invested cash balances. Interest on the Coal Severance Tax Permanent Fund and most interest on cash balances is deposited in the general fund. Interest on other trust funds and some invested cash is earmarked and deposited in special revenue accounts.

The Board of Investments manages the trust funds and agency cash balances. Most trust fund and agency balances are held as shares in one of two mutual funds that the Board of Investments manages, the Trust Fund Bond Pool (TFBP) and the Short Term Investment Pool (STIP). The individual trust funds hold most of their assets in the form of TFBP shares. The TFBP holds a portfolio consisting primarily of long-term bonds and is managed to provide consistent interest earnings. Most agency funds and a small part of trust fund balances are held in STIP shares. The STIP holds a portfolio of short-term bonds and is managed to allow daily deposits and withdrawals while still paying interest.

Historical and Projected Yields

Table 1 shows actual annual percentage yields of the Trust Fund Bond Pool and Short Term Investment Pool for FY 1997 through FY 2004 and projections for FY 2005 through FY 2007. The TFBP yield is forecast to increase in FY 2005, and then decrease in FY 2006. The STIP yield is forecast to increase in FY 2005, FY 2006 and FY 2007, driven by projected increases in the general rate of interest.

Table 1		
TBFP and STIP Yields		
Fiscal Year	Trust Fund Bond Pool	Short Term Investment Pool
A 1998	7.63%	5.89%
A 1999	7.51%	5.43%
A 2000	7.06%	5.95%
A 2001	7.04%	6.64%
A 2002	6.97%	2.84%
A 2003	6.84%	1.54%
A 2004	7.05%	1.10%
F 2005	7.16%	2.12%
F 2006	6.23%	3.28%
F 2007	6.21%	3.68%

Short Term Investment Pool

The Short Term Investment Pool holds a portfolio of short-term corporate and government bonds. A statistical analysis was performed comparing STIP yields to interest rates on combinations of a few corporate and government bonds. The best

statistical fit was found to be a model which predicts the STIP yield to be 98.6% of a weighted average of the rate on three-month commercial paper, the rate on two-year treasury notes, and the previous year's two-year treasury note rate. The weights are 31.3% on commercial paper; 39.0% on treasury notes; and 29.7% on the previous year's treasury notes.

Table 2 shows actual interest rates on three-month commercial paper and two-year treasury notes, and the STIP yield for FY 2001 through FY 2004 and forecasts for FY 2005 through FY 2007.

Rates on three-month commercial paper and two-year treasury notes fell in FY 2002 and FY

2003. The rate on commercial paper fell in FY 2004 but the rate on two-year treasuries rose 0.12 percentage points. Both rates are projected to rise substantially in FY 2005. The STIP yield decreased steadily through FY 2004 but is projected to increase about 2.5 percentage points from FY 2004 through FY 2007.

Table 2 Short Term Investment Pool Yield				
Fiscal Year	Three-Month Commercial Paper	Current Two-Year Treasury Notes	Last Year's Two-Year Treasury Notes	Short Term Investment Pool
A 2001	5.52%	5.18%	6.17%	6.64%
A 2002	2.21%	3.24%	5.18%	2.84%
A 2003	1.39%	1.80%	3.24%	1.54%
A 2004	1.04%	1.92%	1.80%	1.10%
F 2005	2.26%	2.90%	1.92%	2.12%
F 2006	3.46%	3.99%	2.90%	3.28%
F 2007	3.59%	4.04%	3.99%	3.68%

Trust Fund Bond Pool

The Trust Fund Bond Pool holds a portfolio of long-term government and corporate bonds. Income the trust funds receive comes from several sources. The most important of these sources is interest paid on the bonds. This interest accumulates monthly according to the coupon rate printed on the bond. Interest income is fairly consistent from month to month, but it does vary with the average coupon rate of the pool. The average coupon rate of the pool varies due to replacement of older issues in the pool with newer issues. Interest income generally accounts for 70% to 95% of the income received by the bond pool.

The accretion of discount prices and amortization of premium prices is another important source of investment income. A bond is issued with a par value, a maturity date and a coupon rate that is a percentage of the par value. The par value is the price for which the bond may be redeemed at maturity. The coupon rate is the percentage of par that will be distributed annually as interest payments. For instance, a bond may be issued with a par value of \$10,000, a maturity of 20 years and a coupon of 5%. This bond will provide interest income of \$500 annually until its redemption for \$10,000 in 20 years. The holder may sell the bond at any time between the date of issue and the date of redemption. The bond may sell at a premium or at a discount. Selling at a premium means the bond sells for more than

the \$10,000 par value. For a bond to sell at a premium means the promise of \$10,000 at redemption plus the promise of annual interest payments of \$500 until redemption is worth more to the buyer than \$10,000 in hand. If the bond is purchased at a premium (discount) the price must be amortized (accrued) until the expected date of maturity, sale or call. This means the difference between the purchase price and the par price is divided by the number of years until expected disposal to accrue the expected difference annually. This accrual is counted as income. Net accretion is the sum of accruals over all issues in the pool. Net accretion accounted for 7.3% of investment income in FY 2004, increasing from 0.12% in FY 1998.

Capital gains (losses) realized when bonds are sold from the pool are another component of investment income. A capital gain is the difference between the book price and the sale price of the bond. The book price of the bond is the purchase price adjusted for net accretion since the time of purchase. The sale price reflects current market perceptions of the risk of default and the attraction of the coupon. As the coupon rate of new issues decreases, the coupons of bonds currently held in the portfolio appear more attractive, so the market price of these older bonds rises. As the coupon rate of new issues increases, the interest rate on bonds currently held appears less attractive and their price falls. Thus capital gains income tends to move inversely with the average coupon rate of new issues of similar risk. Capital gains income was 14% of investment income in FY 2004, though generally capital gains contribute a much smaller proportion of bond pool income. In FY 2001 this contribution was negative.

Bonds are rated according to their risk of default. Bonds default when the issuer fails to pay coupon obligations or fails to redeem the notes at maturity. "BAA" is a rating attached to some bonds to identify them as investment grade bonds of moderate risk. Securities purchased by the Board of Investments for the trust fund bond pool are of this quality or better, so forecasts of average BAA coupon rates were used to forecast interest and capital gains income.

Securities lending income is a minor source of bond pool investment income. Securities held in the bond pool are occasionally loaned to broker/dealers and other entities to provide security for transactions. Fees are charged for the use of the securities and collateral is collected to protect the pool from the associated investment risk. This collateral may be cash, government securities or irrevocable bank letters of credit. Cash collateral is invested in a collective investment pool, the Securities Lending Quality Trust. Income from investment in this pool combined with the lending fees obtained from the borrowers of the securities make up lending income. This income has contributed less than 0.5% of bond pool investment income in every year since FY 1998.

Bond pool investment income is the sum of interest accruals, net accretion, net capital gains and miscellaneous income after deducting administrative expenses. Miscellaneous income is generally very small and unpredictable, so it was assumed

to be zero in FY 2005 through FY 2007. Administrative expenses tend to be constant within a fiscal year. Since the first two months of FY 2005 showed administrative expenses of \$18,177.00 per month, expenses in the remaining months were forecast at that level. Administrative expenses in FY 2006 and FY 2007 were forecast to be \$18,356.50 per month, the average of FY 2002 through FY 2005.

Net accretion grew steadily from FY 1998 through FY 2002, and then jumped up almost \$3 million to \$6.83 million for FY 2003. Net accretion then declined slightly to \$6.40 million for FY 2004. Net accretion for July and August of FY 2005 are known at this time. The remaining months in FY 2005 and all months in FY 2006 and FY 2007 were forecast at the monthly average for FY 2003 and FY 2004. This forecast net accretion of \$6.55 million for FY 2005 and \$6.62 million for FY 2006 and FY 2007.

Interest income was forecast with an autoregressive model using one lag on interest and the average new issue BAA rated bond coupon rate as predictive variables. This means the value of interest income in January 2005 was assumed to be a function of the value of interest income in December 2004 and the value of the BAA bond rate in January 2005. Since the future values of the BAA bond rate were unknown, a commercial forecast of these values was used instead. Lending income was also forecast using an autoregressive model, but in this case the BAA bond rate was not used as a predictive variable. The sole predictor of lending income was the value of lending income in the previous month. Net capital gains income was forecast with a simple model using the BAA bond rate as the sole predictor. No lags on net gains were included in the model.

Table 3 shows the components of investment income, total investment income, and the BAA bond rate for FY 1998 through FY 2007.

Table 3 Components of Income (\$ millions)								
Fiscal Year	Admin Expense	Interest Income	Other Income	Net Accretion Income	Security Lending Income	Net Capital Gains	Total Investment Income	BAA Bond Rate
A 1998	-0.137	71.848	0.005	0.094	0.203	3.671	75.684	7.43%
A 1999	-0.149	72.450	0.014	0.111	0.331	4.559	77.315	7.38%
A 2000	-0.197	78.891	0.001	1.898	0.304	0.697	81.594	8.32%
A 2001	-0.186	82.175	0.000	3.616	0.193	-1.747	84.050	8.11%
A 2002	-0.234	79.317	0.001	3.888	0.392	0.145	83.508	7.96%
A 2003	-0.225	73.217	0.240	6.835	0.138	1.115	81.320	7.21%
A 2004	-0.204	68.053	0.063	6.403	0.159	12.315	86.789	6.60%
F 2005	-0.218	67.891	0.000	6.550	0.205	18.583	93.011	6.74%
F 2006	-0.220	70.939	0.000	6.619	0.240	6.126	83.703	7.33%
F 2007	-0.220	71.437	0.000	6.619	0.241	7.947	86.024	7.12%

The \$18.58 million of realized capital gains income forecast in FY 2005 includes \$3.52 million observed in July and \$6.04 million observed in August. These were the second and third highest monthly gains observed since FY 1998.

The rate of return on the Trust Funds Bond Pool is given by the ratio of income per share and the par value of one share. Income per share is given by the ratio of annual investment income and the number of shares outstanding. Par value of one share is \$100. The number of shares outstanding was modeled using a time trend and one lag on shares as predictor variables.

Table 4 shows investment income, shares outstanding and rate of return for FY 1998 through FY 2007.

Investment income and the rate of return are forecast to:

- increase in FY 2005 due primarily to the high gains observed in July and August of 2004; and
- decrease in FY 2006 and FY 2007 from the FY 2005 level.

Table 4 Income, Shares Outstanding and Rate of Return				
Fiscal Year	Investment Income (\$ millions)	Shares Outstanding (millions)	Income Per Share (\$ dollars)	Rate of Return; Par = 100
A 1998	\$75.684	9.917	\$7.631	7.63%
A 1999	\$77.315	10.296	\$7.509	7.51%
A 2000	\$81.594	11.552	\$7.063	7.06%
A 2001	\$84.050	11.936	\$7.042	7.04%
A 2002	\$83.508	11.985	\$6.968	6.97%
A 2003	\$81.320	11.890	\$6.840	6.84%
A 2004	\$86.789	12.314	\$7.048	7.05%
F 2005	\$93.011	12.991	\$7.160	7.16%
F 2006	\$83.703	13.430	\$6.233	6.23%
F 2007	\$86.024	13.857	\$6.208	6.21%

COAL TRUST FUND INTEREST

Revenue Description

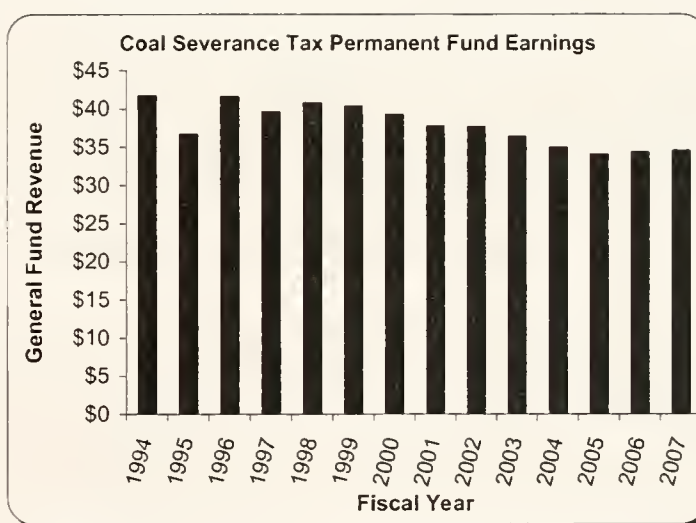
Article IX, section 5 of the Montana Constitution established a permanent trust fund into which at least half of coal severance tax revenue must be deposited. Under current law, half of severance tax revenue is deposited in the trust fund, which is divided into several funds with different purposes. Interest earnings from the coal severance tax permanent fund and the coal severance tax bond fund are paid into the state general fund.

Historical and Projected Revenue

Table 1 shows interest income payments from these coal tax trust funds to the general fund from FY 1994 through FY 2004, and forecasts for FY 2005 through FY 2007.

Table 1
Coal Tax Fund Interest Earnings
(\$ millions)

	<u>Fiscal Year</u>	<u>General Fund</u>	<u>Percent Change</u>
A	1994	41.725	-16.19%
A	1995	36.675	-12.10%
A	1996	41.532	13.24%
A	1997	39.554	-4.76%
A	1998	40.746	3.01%
A	1999	40.306	-1.08%
A	2000	39.195	-2.76%
A	2001	37.660	-3.92%
A	2002	37.605	-0.14%
A	2003	36.298	-3.48%
A	2004	34.907	-3.83%
F	2005	34.003	-2.59%
F	2006	34.293	0.85%
F	2007	34.484	0.56%



No deposits were made to the permanent fund in the 2003 biennium. Beginning in FY 2004, the trust fund balance will grow as 12.5% of severance tax collections are deposited in the permanent fund. Interest earnings have fallen every year since FY 1998, because long-term interest rates on new bonds have been lower than on bonds already in the trust fund portfolio. In FY 2005 through FY 2007, interest earnings are projected to remain relatively constant at about \$34 million each year.

Background on Non-Commercial Loans

Up to 25% of the combined balance of the permanent fund, the treasure state endowment fund, and the treasure state endowment regional water system fund is to be invested in Montana companies, with an emphasis on new and expanding businesses (17-6-305, MCA). These investments take the form of fixed rate loans to private companies. All of these loans are made from the permanent fund, so they can make up more than 25% of the permanent fund portfolio. In FY 2004, many of these fixed rate loans were repaid because the rates on commercial loans were at historic lows.

Pursuant to SB 495 (2001 session), the permanent fund made a loan of \$46.337 million to the common school trust. The school trust pays interest on this loan at last year's trust fund bond pool rate, and a portion of mineral royalties from state school lands are pledged to repay the principal of the loan. Projected repayments are explained in the School Trust Interest and Income Forecast.

The legislature has authorized the Board of Investments to make loans from the permanent fund to the Department of Justice to pay the cost of a lawsuit to recover Superfund cleanup costs. HB 160 renewed this authority (2003 session). The loan is to be repaid with interest from funds recovered from this lawsuit, but no interest is paid until then. The Board of Investments lends funds to the Department of Justice as they are expended.

SB 131 authorized the Board of Investments to invest up to \$5 million of the permanent fund in local economic development organizations' revolving loan programs. These loans are to have an interest rate of no more than 2%. At the end of April 2004, loans totaling \$3.719 million had been made.

Forecast Methodology and Projection Calculation

There are three steps to forecasting general fund revenue from the coal severance tax permanent fund and the coal severance tax bond fund. First, the annual average balance of the funds must be projected. Second, the annual percentage yield of the funds is projected. Finally, payments to the general fund are estimated by multiplying the average annual balance by the annual percentage yield.

Permanent Trust Fund Balance

Half of coal severance tax collections are deposited in the coal trust funds. Beginning in FY 2004, 12.5% of coal severance tax collections will go to the permanent fund. Coal severance tax deposits to the trust fund are projected to be \$3.303 million in FY 2005, \$3.998 million in FY 2006, and \$3.858 million in FY 2007. Severance tax is collected quarterly, and the average balance during a fiscal year equals the beginning balance plus the quarterly deposits, each multiplied by the

fraction of the year remaining when the deposit is made. If the deposits are of equal size, the increase in the average balance is $\frac{3}{8}$ of the sum of the deposits:
 $(\frac{3}{8} = \frac{1}{4} \times \frac{3}{4} + \frac{1}{4} \times \frac{1}{2} + \frac{1}{4} \times \frac{1}{4} + \frac{1}{4} \times 0)$.

Table 2 shows actual beginning and ending balances along with coal severance tax deposits for FY 2004, and projections for FY 2005, FY 2006 and FY 2007.

Table 2 Trust Fund Balances (\$ millions)				
	<u>FY 2004</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Beginning Trust Fund Balance	\$542.450	\$546.891	\$550.194	\$554.193
Coal Severance Tax Deposits	\$4.441	\$3.303	\$3.998	\$3.858
Ending Trust Fund Balance	<u>\$546.891</u>	<u>\$550.194</u>	<u>\$554.193</u>	<u>\$558.051</u>
Average Trust Fund Balance	\$544.200	\$548.280	\$552.348	\$556.233

The permanent fund balance is invested primarily in three vehicles managed by the Board of Investments (BOI). These vehicles are the Trust Funds Bond Pool (TFBP), the Short Term Investment Pool (STIP), and commercial and non-commercial loans. TFBP and STIP are mutual funds managed by the Board of Investments. TFBP holds a portfolio of long-term corporate and government bonds. It is managed to provide reliable long-term interest earnings. STIP holds a portfolio of short-term bonds and is managed to allow daily transactions while still paying some interest.

The forecast assumes that the portion of the permanent fund balance invested in loans, STIP, and TFBP are fixed. The loan and STIP portions are set at the median proportions for FY 2003 and FY 2004. The TFBP portion is the remaining balance. For each month, the balance is projected from the previous month's balance plus estimated coal severance tax payments.

Table 3 shows the portion of the permanent fund average balance by type of investment.

Table 3 Coal Trust Permanent Fund Average Balance by Investment Type (\$ millions)							
Fiscal Year	Loan Balance	% Total	STIP Balance	% Total	TFBP Balance	% Total	Average Balance
A 2001	\$129.505	23.78%	\$13.851	2.54%	\$401.252	73.68%	\$544.608
A 2002	\$191.338	35.41%	\$28.797	5.33%	\$320.238	59.26%	\$540.374
A 2003	\$230.041	42.36%	\$18.399	3.39%	\$294.584	54.25%	\$543.024
A 2004	\$207.459	38.12%	\$32.432	5.96%	\$304.309	55.92%	\$544.200
F 2005	\$213.203	38.89%	\$24.738	4.51%	\$310.339	56.60%	\$548.280
F 2006	\$216.402	39.18%	\$25.802	4.67%	\$310.144	56.15%	\$552.348
F 2007	\$217.924	39.18%	\$25.983	4.67%	\$312.325	56.15%	\$556.233

Annual Permanent Trust Fund Yield

Table 4 shows investment incomes and rates of return on the permanent fund average balances. Loan yields are fixed at the average loan yield for the previous 12 months. STIP and TFBP yields are the projected rates for STIP and TFBP discussed in the Introduction to Interest chapter. Multiplying the average balance by the yield derives investment income.

Table 4 Coal Trust Permanent Fund Income and Yield (\$ millions)								
Fiscal Year	Loan Income	% Return	STIP Income	% Return	TFBP Income	% Return	Total Income	Total Yield
A 2001	\$7.198	5.56%	\$0.884	6.38%	\$29.456	7.34%	\$37.538	6.89%
A 2002	\$11.691	6.11%	\$0.861	2.99%	\$23.273	7.27%	\$35.825	6.63%
A 2003	\$13.913	6.05%	\$0.264	1.43%	\$21.004	7.13%	\$35.181	6.48%
A 2004	\$12.470	6.01%	\$0.362	1.12%	\$22.319	7.33%	\$35.151	6.46%
F 2005	\$12.664	5.94%	\$0.500	2.02%	\$20.697	6.67%	\$33.861	6.18%
F 2006	\$13.039	6.03%	\$0.846	3.28%	\$20.187	6.51%	\$34.073	6.17%
F 2007	\$13.131	6.03%	\$0.956	3.68%	\$20.150	6.45%	\$34.237	6.16%

Bond Trust Fund Balance and Yield

A balance is maintained in the coal severance tax bond fund equal to principal and interest payments due in the next year on coal severance tax bonds. This provides a reserve fund that guarantees that bond payments will be made even if unforeseen events occur. Having a reserve fund allows the state to obtain a lower interest rate when it sells bonds. All invested funds in the bond fund are invested in STIP. The average STIP balance for the first three months of FY 2005 was \$6.706 million. The forecast assumes this balance will be maintained throughout the forecast period.

Table 5 shows the actual and projected annual average bond fund STIP balance, the STIP rate of return and the interest income on this balance for FY 2001 through FY 2007. Interest income is the product of the average balance times the rate of return.

Table 5 Coal Tax Bond Fund Interest Income				
FY	Average Balance		% Return	Interest Income
A 2001	\$5.930	X	9.37%	= \$0.556
A 2002	\$5.676	X	4.15%	= \$0.235
A 2003	\$6.134	X	2.03%	= \$0.124
A 2004	\$6.018	X	1.48%	= \$0.089
F 2005	\$6.706	X	2.12%	= \$0.142
F 2006	\$6.706	X	3.28%	= \$0.220
F 2007	\$6.706	X	3.68%	= \$0.247

General Fund Revenue

Table 6 shows the total earnings for the permanent fund and the bond fund for the general fund revenue estimate. The combined fund balance increases every year from FY 2002 through FY 2007, but the combined income decreases from FY 2001 through FY 2005. This is primarily due to decreasing returns in the commercial loan and bond markets. The income grows slightly for FY 2006 and FY 2007 as the fund balance increases and the yield remains fixed. General fund revenue will be about \$34 million each year.

Table 6					
Coal Severance Tax General Fund Interest Earnings					
Fiscal Year	Combined Fund Balance		Combined Fund Yield		Combined Fund Income
A 2001	\$550.537	X	6.92%	=	\$38.093
A 2002	\$546.049	X	6.60%	=	\$36.061
A 2003	\$549.158	X	6.43%	=	\$35.306
A 2004	\$550.218	X	6.40%	=	\$35.240
F 2005	\$554.987	X	6.13%	=	\$34.003
F 2006	\$559.054	X	6.13%	=	\$34.293
F 2007	\$562.939	X	6.13%	=	\$34.484

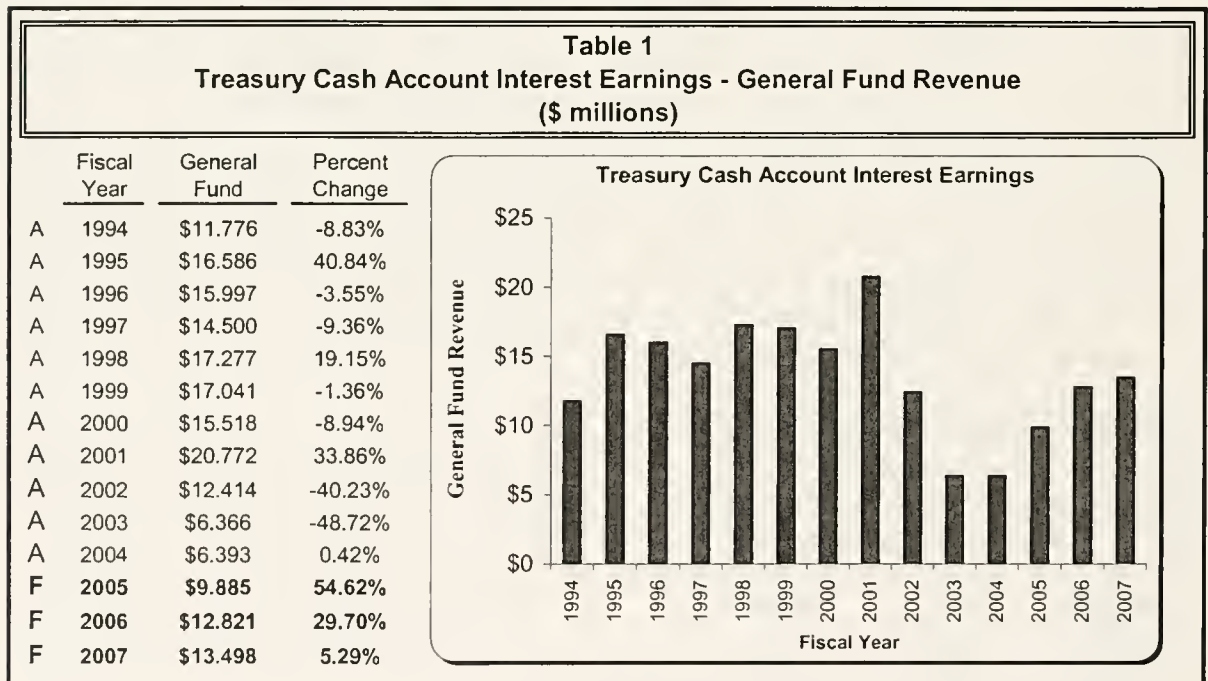
TREASURY CASH ACCOUNT INTEREST

Revenue Description

The state Board of Investments invests cash on hand in the state treasury. Interest earned on this Treasury Cash Account (TCA) is paid into the general fund (§17-6-202, MCA). The balance in the TCA increases in months when receipts are more than expenditures. It decreases in months when receipts are less than expenditures. In many years, the state borrows money to maintain a positive balance in the general fund by issuing tax or revenue anticipation notes (TRANS). TRANS are short-term bonds that are repaid in the same fiscal year that they are issued (§ 17-1-201, MCA). Issuing TRANS increases the average balance in the TCA and, therefore, increases the interest earned on the account. However, the state must pay interest on the TRANS.

Historical and Projected Revenue

Table 1 shows actual general fund revenue from TCA earnings for FY 1994 through FY 2004, and forecasts of earnings for FY 2005 through FY 2007.



In FY 2003 and FY 2004, interest rates were lower than at any time in the previous fifty years, and TCA interest earnings were significantly lower than in any of the previous ten years. Interest rates are projected to rise slowly through FY 2007. Average balances are projected to be higher than the average over the last ten

years due to recent legislation. TCA interest earnings are projected to increase significantly in FY 2005 and FY 2006, and then increase 5.29% in FY 2007.

Forecast Methodology and Projection Calculation

There are three steps to forecasting interest earnings on the Treasury Cash Account:

1. Projecting the average balance in the account;
2. Projecting the annual average yield; and
3. Multiplying the projected balance by the projected yield to give projected earnings.

Average Balance

The balance in the TCA changes over the course of a fiscal year. There are two reasons for this. One is that revenues and expenditures are not equal most months. General fund expenditures tend to be greater than revenues in the first months of the fiscal year, and general fund revenues tend to be greater than expenditures later in the fiscal year. This causes the balance of the TCA to fall during the first part of the fiscal year and recover in the last part of the fiscal year. Other funds have receipts and expenditures that vary over time. However, not all receipts and expenditures follow regular annual patterns, and the pattern of monthly TCA balances varies from year to year.

The other reason for changes in the balance during a fiscal year is that in many years the state issues TRANS. These are short-term bonds that the state issues and repays during the same fiscal year. They are issued to ensure that the balance in the general fund is never negative. When they are issued, the TCA balance increases by the amount of the TRANS issued. When they are repaid at the end of the fiscal year, the balance decreases by the same amount. Issuing TRANS increases the average account balance during years in which they are issued.

The account ending balance also changes from year to year when revenues and expenditures do not balance. In years when revenues exceed expenditures, the year-end balance in the TCA will be greater than the beginning balance. In years when revenues are less than expenditures, the ending balance will be less than the beginning balance.

Table 2 shows the average and ending balances in the TCA for FY 1990 through FY 2004.

The highest and lowest year-end balances in this period differ by more than \$200 million, but there was relatively little variation in the average balances. The average TCA balance in FY 1990 through FY 2001 was \$298.290 million. The average balance in FY 1992 was much lower than in the other years in this period. Excluding FY 1992, the average was \$304.034 million.

Recent legislation is estimated to have reduced the average balance by \$20 million in FY 2002. Without this legislative change, the average balance for FY 2002 would have been fairly close to the average for FY 1991 through FY 2001. Other legislation passed that was estimated to increase the average balance by \$42.685 million in FY 2003.

Table 2 TCA Average and Ending Balance (\$ millions)		
Fiscal Year	Average Balance	Ending Balance
1990	\$314.829	\$355.761
1991	\$284.911	\$292.950
1992	\$235.108	\$205.817
1993	\$283.886	\$255.314
1994	\$304.673	\$331.294
1995	\$305.502	\$275.808
1996	\$314.871	\$406.381
1997	\$289.989	\$289.501
1998	\$296.873	\$335.730
1999	\$310.518	\$394.460
2000	\$303.628	\$439.395
2001	\$334.705	\$417.768
2002	\$273.343	\$325.570
2003	\$273.929	\$347.503
2004	\$311.478	\$441.236

TRANS issues smooth out year-to-year variations in balances as well as variations in balances within a fiscal year. When general fund balances are lower than normal early in the fiscal year, more TRANS are issued. When general fund balances are higher than normal in the early months of the fiscal year, fewer or no TRANS are issued.

Cash balances in funds other than the general fund vary over time and often do not follow annual patterns. However, over time the average cash balance in all funds that are held in the TCA has been relatively stable.

There have been two changes in law that will affect TCA balances. With the passage of Legislative Referendum 115, the Department of Transportation cash holdings will no longer be part of the TCA. This reduced average balances by \$20 million beginning in FY 2002. HB 16 passed by the 2002 special session placed restrictions on loans between state funds. This was expected to reduce non-interest paying loans from the general fund to other funds and to increase the average TCA balance by \$42.785 million beginning in FY 2003. The net effect was a reduction of \$20 million for FY 2002 and an increase of \$22.8 million beginning in FY 2003.

Table 3 shows the calculation for the projected average TCA balance for FY 2005 through 2007.

The legislation impact is deducted from the average TCA balance for FY 2003 and FY 2004 to get an average balance for these fiscal years that is consistent with the prior years.

Then the adjusted average TCA balance for FY 1990 to FY 2004, excluding the outlier years 1992 and 2002 from the series is calculated.

Then the \$22.8 million legislation impact is added to the average TCA balance to reflect the recent legislation changes. This results in a projected average balance of \$321.584 million for fiscal years 2005 through 2007.

Table 3 Calculation of Average TCA Balance FY 2005 through FY 2007		
	FY 2003	FY 2004
Average TCA Balance	273.929	311.478
Subtract Legislation Impact	22.800	22.800
Adjusted Average TCA Balance	251.129	288.678
	Fiscal Year	Average Balance
	1990	\$314.829
	1991	\$284.911
	1993	\$283.886
	1994	\$304.673
	1995	\$305.502
	1996	\$314.871
	1997	\$289.989
	1998	\$296.873
	1999	\$310.518
	2000	\$303.628
	2001	\$334.705
	2003	\$251.129
	2004	\$288.678
TCA Average Balance		\$298.784
Add Legislative Impact		22.800
Projected Average TCA Balance		\$321.584

Yields

The TCA is managed by the Board of Investments. Part of the TCA balance is invested in the Board of Investments Short Term Investment Pool (STIP), which holds short-term commercial and government bonds. The rest of the TCA balance is held in short-term assets similar to those in the STIP portfolio. The forecast of the STIP yield is explained in the introduction to interest earnings.

Over many years, the average TCA yield is very close to the average STIP yield, but they can differ significantly in any one year. The TCA yield tends to be higher than the STIP yield in years when interest rates are falling and lower in years when interest rates are rising. This is consistent with the way that the Board of Investments manages the TCA.

The TCA balance changes by as much as \$100 million over the course of a fiscal year. The Board of Investments buys bonds in months when the TCA balance is increasing and sells them in months when the TCA balance is decreasing. It generally does not hold bonds to maturity. When interest rates change between the time the Board of Investments buys bonds and when it sells them, it realizes a

capital gain or loss on the sale. When interest rates fall, bond prices rise and there is a capital gain. When interest rates rise, bond prices fall and there is a loss.

The income earned on the TCA balance consists of interest earnings and gains or losses on bond sales. When interest rates rise, the annual yield on the TCA balance rises, but not as much as interest rates rise because of offsetting losses on bond sales. When interest rates fall, the TCA yield falls, but because of offsetting gains on bond sales, not by as much as interest rates fall.

Statistical forecasting models were estimated for FY 1979 through FY 2004 using several different short-term interest rates to predict the TCA yield. The model with the smallest margin of error predicts the TCA yield from the STIP yield and annual changes in the STIP yield. It predicts a higher TCA yield when the STIP yield has fallen from last year and a lower TCA yield when the STIP yield has risen from last year, and the effect is more than proportional to the change in the STIP yield. This model is shown in Table 4.

Table 4 TCA Yield Forecasting Model					
TCA yield	=	0.8294%			
	+	0.8696	x	STIP yield	
	+	0.3992	x	Change in STIP yield	
	-	17.5184	x	Signed Square of Change in STIP Yield	
	-	0.4366	x	(Previous TCA Yield - Trend)	

The change in STIP yield is the difference in STIP yields between the present and the prior year. The signed square of change in STIP yield is calculated by squaring this difference and applying the sign of the original change to the result. The last step is necessary to preserve the sign of the change, because multiplying a negative number by itself gives a positive number.

Table 5 shows actual STIP and TCA yields for FY 2001 through FY 2004 and the model's forecasts for FY 2005 through FY 2007. Yields are expected to rise through FY 2007 due to predicted increases in short-term interest rates. The projected increases in TCA yield are smaller than projected increases in the STIP yield.

Table 5 TCA Annual Yield - Actual and Model Forecasts					
Fiscal Year	STIP Yield	Change in STIP Yield	Signed Square of Change in STIP Yield	TCA Yield	Change in TCA Yield
A 2001	6.64%	11.60%	0.0048%	6.21%	21.53%
A 2002	2.84%	-57.23%	-0.1444%	4.54%	-26.89%
A 2003	1.54%	-45.77%	-0.0169%	2.32%	-48.81%
A 2004	1.10%	-28.52%	-0.0019%	2.05%	-11.69%
F 2005	2.12%	92.41%	0.0103%	3.07%	49.77%
F 2006	3.28%	54.86%	0.0135%	3.99%	29.70%
F 2007	3.68%	12.26%	0.0016%	4.20%	5.29%

TCA Interest Earnings

Table 6 shows actual TCA average balances, yields and earnings for FY 2003 and FY 2004 and the projected values for FY 2005 through FY 2007. TCA interest earnings are projected to be \$9.9 million in FY 2005, \$12.8 million in FY 2006, and \$13.5 million in FY 2007.

Table 6
Calculation of TCA Earnings
(\$ millions)

<u>Fiscal Year</u>	<u>Average Balance</u>		<u>TCA Yield</u>		<u>Projected Earnings</u>
A 2003	\$273.929	x	2.32%	=	\$6.366
A 2004	\$311.478	x	2.05%	=	\$6.393
F 2005	\$321.584	x	3.07%	=	\$9.885
F 2006	\$321.584	x	3.99%	=	\$12.821
F 2007	\$321.584	x	4.20%	=	\$13.498

LIQUOR EXCISE AND LICENSE TAX

Revenue Description

Sections 16-1-401 (excise tax) and 16-1-404 (license tax), MCA, direct the Department of Revenue to collect an excise tax of 16%, and a license tax of 10% of the retail selling price on all liquor sold and delivered in the state. The tax is 13.8% (excise tax), and 8.6% (license tax) of the retail selling price if the liquor manufacturer sold not more than 200,000 proof gallons of liquor nationwide in the preceding calendar year. Both the excise and license tax are paid directly by liquor store owners when they purchase liquor from the State Liquor Warehouse. A small portion of liquor excise tax revenue is refunded to three Indian tribes that have a revenue sharing agreement with the state, with the remaining revenue deposited in the state general fund. The liquor license tax is deposited 34.5% in the state general fund and 65.5% to the Department of Public Health and Human Services to fund alcohol treatment programs.

Historical and Projected Revenue

Table 1 shows historical and projected liquor excise and license tax general fund revenue for FY 1994 through FY 2007.

Table 1 Liquor Excise and License Tax Historical and Forecast Collections (\$ millions)			Liquor Excise Tax
Fiscal Year	General Fund	Percent Change	
A 1994	\$6.324		
A 1995	\$6.200	-1.96%	
A 1996	\$7.203	16.17%	
A 1997	\$6.107	-15.21%	
A 1998	\$6.412	5.00%	
A 1999	\$6.666	3.96%	
A 2000	\$7.172	7.58%	
A 2001	\$7.343	2.38%	
A 2002	\$9.514	29.56%	
A 2003	\$10.042	5.55%	
A 2004	\$10.718	6.73%	
F 2005	\$11.109	3.65%	
F 2006	\$11.476	3.31%	
F 2007	\$11.856	3.31%	

Liquor excise tax general fund revenue spiked in FY 1996 due to sales from privatizing the state-owned liquor stores. When privatization occurred, the state sold state-owned liquor merchandise in the state liquor stores to the new store owners. This resulted in higher dollar and unit sales, but not increased consumption. FY

1997 shows a decline in sales due to selling the liquor inventory to the private liquor store owners in FY 1996.

HB 124 (2001 session) changed the distribution of the liquor license tax. Prior to FY 2002, 34.5% of the liquor license tax was distributed to local governments. Beginning in FY 2002, all of the liquor license tax is deposited in the state general fund. This change explains the 29.56% growth in state general fund revenue in FY 2002 from this revenue source.

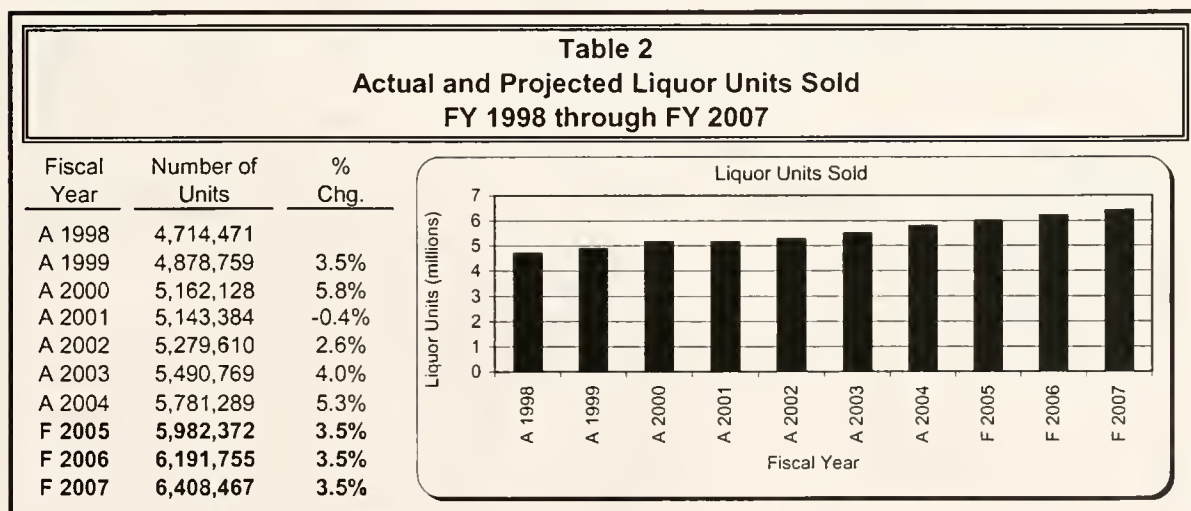
The forecast projects liquor excise and license tax general fund revenue to increase 3.71% in FY 2005, and 3.31% annually in FY 2006 and FY 2007.

Forecast Methodology and Projection Calculation

There are four steps to estimate general fund revenues each fiscal year from the liquor excise and license tax: calculate gross sales; calculate retail selling value; calculate gross liquor excise and license tax collections; and calculate liquor excise and license tax general fund revenue.

Step 1: Calculate Gross Sales

The first step in estimating liquor excise and license tax receipts is to calculate gross sales. There are three components to this calculation: the number of liquor units sold; the cost per liquor unit; and the gross sales-to-cost ratio. Table 2 shows actual and projected liquor units sold from FY 1998 through FY 2007. The number of liquor units sold in FY 2005 through FY 2007 is projected to increase 3.5% annually, which is the average annual growth rate from FY 1998 through FY 2004.



Cost per liquor unit sold is the cost of goods sold divided by the number of liquor units sold. The actual cost per liquor unit, and the annual percent change for FY 1998 through FY 2004 is shown in Table 3. Cost per liquor unit sold for FY 2005 through FY 2007 is projected to increase 1.64% annually. This is the average annual growth rate from FY 1998 through FY 2004, excluding the high year (FY 2001) and the low year (FY 1999).

Table 3
Actual and Projected Cost per Liquor Unit
FY 1998 through FY 2007

Fiscal Year	Cost of Goods Sold	Number of Units	Cost per Unit	Annual % Change
A 1998	\$29,121,673	4,714,471	\$6.177	
A 1999	\$30,201,100	4,878,759	\$6.190	0.21%
A 2000	\$32,318,269	5,162,128	\$6.261	1.14%
A 2001	\$33,666,541	5,143,384	\$6.546	4.55%
A 2002	\$35,279,453	5,279,610	\$6.682	2.09%
A 2003	\$37,321,005	5,490,769	\$6.797	1.72%
A 2004	\$39,933,421	5,781,289	\$6.907	1.62%
F 2005		5,876,102	\$7.021	1.64%
F 2006		5,972,470	\$7.136	1.64%
F 2007		6,070,419	\$7.253	1.64%

The sales-to-cost ratio is gross sales divided by the cost of goods sold. Table 4 shows this ratio and the annual percent change for FY 1998 through FY 2004. The sales-to-cost ratio for FY 2005 through FY 2007 is projected to remain fixed at the FY 2004 level of 1.774.

Table 4
Historical and Projected Sales to Cost Ratio
FY 1995 through FY 2005

Fiscal Year	Gross Sales	/	Cost of Goods Sold	=	Sales to Cost Ratio	% Chg.
A 1998	\$51,381,137	/	\$29,121,673	=	1.764	
A 1999	\$53,679,508	/	\$30,201,100	=	1.777	0.74%
A 2000	\$57,467,696	/	\$32,318,269	=	1.778	0.04%
A 2001	\$58,844,284	/	\$33,666,541	=	1.748	-1.71%
A 2002	\$62,514,926	/	\$35,279,453	=	1.772	1.38%
A 2003	\$66,123,983	/	\$37,321,005	=	1.772	-0.01%
A 2004	\$70,827,539	/	\$39,933,421	=	1.774	0.11%
F 2005					1.774	0.00%
F 2006					1.774	0.00%
F 2007					1.774	0.00%

Gross sales for FY 2005 through FY 2007 are calculated as the product of the projected number of liquor units sold, the estimated cost per unit, and the projected sales-to-cost ratio, as shown in Table 5.

Table 5
Estimated Gross Liquor Sales
FY 2005 through FY 2007

Fiscal Year	Number of Liquor Units	x	Cost per Unit	x	Sales/Cost Ratio	=	Estimated Gross Sales
2005	5,876,102	x	\$7.021	x	1.774	=	\$73,169,732
2006	5,972,470	x	\$7.136	x	1.774	=	\$75,589,379
2007	6,070,419	x	\$7.253	x	1.774	=	\$78,089,041

Step 2: Calculate Retail Selling Value

The liquor store owner pays both liquor excise (16%) and liquor license (10%) taxes. These taxes are in the gross sales in Table 5. As shown in Table 6, to estimate the pre-tax retail value of liquor sales, gross liquor sales are divided by the combined liquor excise and liquor license tax rate of 1.26.

Table 6				
Calculation of Liquor Sales Retail Value				
FY 2005 through FY 2007				
Fiscal Year	Estimated Gross Sales	/	1 + (Combined Tax Rate*)	= Estimated Retail Value
2005	\$73,169,732	/	1.26	= \$58,071,216
2006	\$75,589,379	/	1.26	= \$59,991,571
2007	\$78,089,041	/	1.26	= \$61,975,429
*Combined Liquor Excise and Liquor License Taxes				

Step 3: Calculate Gross Liquor Excise and License Tax Collections

Liquor excise tax receipts for FY 2005 through FY 2007 are estimated by multiplying the retail value of liquor sales by the liquor excise tax rate as shown in Table 7.

Table 7				
Calculation of Estimated Gross Liquor Excise Tax				
FY 2005 through FY 2007				
Fiscal Year	Estimated Retail Value	x	Liquor Excise Tax Rate	= Estimated Gross Liquor Excise Tax
2005	\$58,071,216	x	16%	= \$9,291,395
2006	\$59,991,571	x	16%	= \$9,598,651
2007	\$61,975,429	x	16%	= \$9,916,069

Liquor license tax receipts for FY 2005 through FY 2007 are estimated by multiplying the retail value of liquor sales by the liquor license tax rate as shown in Table 8.

Table 8				
Calculation of Estimated Gross Liquor License Tax				
FY 2005 through FY 2007				
Fiscal Year	Estimated Retail Value	x	Liquor License Tax Rate	= Estimated Gross Liquor License Tax
2005	\$58,071,216	x	10%	= \$5,807,122
2006	\$59,991,571	x	10%	= \$5,999,157
2007	\$61,975,429	x	10%	= \$6,197,543

Step 4: Calculate Liquor Excise and License Tax General Fund Revenue

The liquor excise tax receipts that are transferred to the general fund are calculated by subtracting the estimated amount of tribal refunds from the gross liquor excise tax projection. As alcohol payments to the tribal governments have averaged 2% of the general fund alcohol collections for FY 2000 through FY 2004, tribal refunds are estimated at 2% of the liquor excise tax for FY 2005 through FY 2007.

Table 9 shows liquor excise tax general fund revenue is estimated to be \$9.1 million in FY 2005, \$9.4 million in FY 2006, and \$9.7 million in FY 2007. Liquor license tax general fund is estimated to be \$2.0 million in FY 2005, \$2.1 million in FY 2006, and \$2.1 million in FY 2007. Total liquor excise tax and liquor license tax general fund revenue is estimated at \$11.1 million for FY 2005, \$11.5 million for FY 2006, and \$11.9 million for FY 2007.

Table 9					
Calculation of Liquor Excise Tax and Liquor License Tax					
General Fund Revenue					
FY 2005 through FY 2007					
Fiscal Year	Estimated Gross Liquor Excise Tax	-	Estimated Tribal Refunds	=	Estimated Liquor Excise Tax General Fund Revenue
2005	\$9,291,395	-	\$185,828	=	\$9,105,567
2006	\$9,598,651	-	\$191,973	=	\$9,406,678
2007	\$9,916,069	-	\$198,321	=	\$9,717,747

Fiscal Year	Estimated Gross Liquor License Tax	X	General Fund Share	=	Estimated Liquor License Tax General Fund Revenue
2005	\$5,807,122	X	34.5%	=	\$2,003,457
2006	\$5,999,157	X	34.5%	=	\$2,069,709
2007	\$6,197,543	X	34.5%	=	\$2,138,152

Fiscal Year	Total General Fund Revenue				
2005	\$11,109,024				
2006	\$11,476,387				
2007	\$11,855,900				

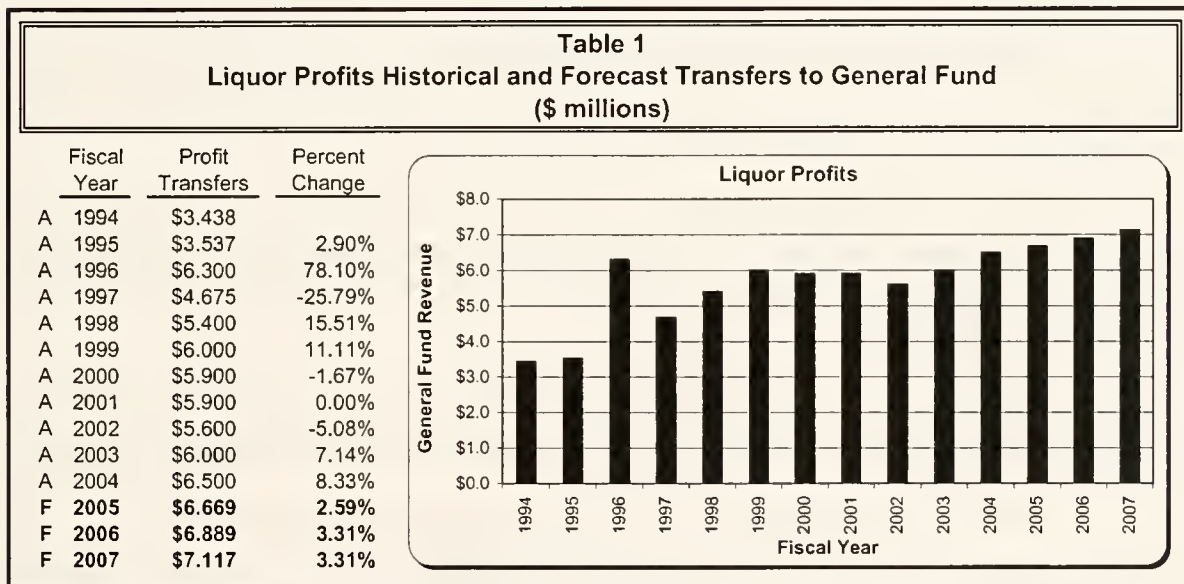
LIQUOR PROFITS

Revenue Description

The Department of Revenue administers liquor laws relating to alcoholic beverage control, sale and distribution, and the licensing of alcoholic beverage manufacturers, wholesalers and retailers (Title 16, chapters 1 through 6, MCA). Agency franchisees purchase liquor products from the state liquor warehouse. A 40% markup on the state's base costs covers the operating costs of the state liquor system and provides a net profit. Liquor profits are transferred to the general fund at fiscal year end.

Historical and Projected Revenue

Table 1 shows historical and projected collections from liquor profits for FY 1994 through FY 2007.



Liquor profit transfers to the general fund have fluctuated over the years, spiking in FY 1996, the year in which the state privatized liquor-retailing operations. The forecast projects liquor profit transfers to the general fund to increase 2.59% in FY 2005, increase 3.31% in FY 2006, and increase 3.31% in FY 2007.

Forecast Methodology and Projection Calculation

The liquor profit transfer to the general fund is based on the net income from liquor operations for the fiscal year. Net income from liquor operations is calculated as gross liquor sales minus less the cost of goods sold, liquor taxes (liquor excise tax

and liquor license tax), commissions, discounts, and operating expenses. The calculations for gross liquor sales, cost of goods sold, and liquor taxes are in the Liquor Excise and License Tax General Fund Revenue Estimate. These will not be duplicated here. This analysis will show the calculation of commissions, discounts, operating expenses, and profits.

Sales Commissions, Discounts, and Operating Expenses

Sales commissions are paid to liquor store owners by the State of Montana. The commission rate was negotiated with liquor store owners when privatization occurred, and varies among store owners. In compliance with the law, the commission rates are negotiated between the Department of Revenue and the store owners every three years. SB 348 (2001 session) increased the commission rates over a three-year period based on the annual sales volume by agency liquor stores. The last SB 348 rate increase went into effect in FY 2005, as did the new negotiated commission rates. The commission rate averaged 9.58% in FY 2004. For FY 2005, FY 2006, and FY 2007 the commission rate is 10.11%. Increasing the discount rate reduces the liquor profits transfer to the general fund.

Discounts are offered to liquor store owners on all purchases. The effective discount rate of 1.94% has remained constant over the last few years, and is assumed to remain constant barring any change in statute.

The Department of Revenue estimates operating expenses to be 1.82% of gross sales. This is based on the FY 2002 through FY 2004 average, and includes the amounts that the liquor enterprise program will be billed for services provided by the Department of Revenue.

Table 2 shows the calculation for commissions, discounts, and operating expenses.

Table 2 Projected Commissions and Discounts and Operating Expenses FY 2005 through FY 2007			
<u>Description</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Gross Sales	\$73,169,732	\$75,589,379	\$78,089,041
Multiplied by: Commission Rate (% of Gross Sales)	10.11%	10.11%	10.11%
Projected Commissions	\$ 7,397,460	\$ 7,642,086	\$ 7,894,802
Gross Sales	\$73,169,732	\$75,589,379	\$78,089,041
Multiplied by: Discount Rate (% of Gross Sales)	1.94%	1.94%	1.94%
Projected Discounts	\$ 1,419,493	\$ 1,466,434	\$ 1,514,927
Gross Sales	\$73,169,732	\$75,589,379	\$78,089,041
Multiplied by: Operating Expenses (% of Gross Sales)	1.82%	1.82%	1.82%
Projected Operating Expenses	\$ 1,331,689	\$ 1,375,727	\$ 1,421,221

Liquor Profit Transfers to the General Fund

Table 3 shows liquor profit calculations for FY 2005 through FY 2007. Liquor profit transfers to the general fund are forecast to be \$6.669 million in FY 2005, \$6.889 million in FY 2006, and \$7.117 million in FY 2007.

Table 3			
Liquor Profits Calculation Summary			
FY 2005 through FY 2007			
<u>Description</u>	<u>FY 2005</u> <u>Estimate</u>	<u>FY 2006</u> <u>Estimate</u>	<u>FY 2007</u> <u>Estimate</u>
Gross Liquor Sales	\$73,169,732	\$75,589,379	\$78,089,041
Less:			
Cost of Goods Sold	41,253,978	42,618,204	44,027,544
Liquor Taxes	15,098,516	15,597,808	16,113,612
Commissions	7,397,460	7,642,086	7,894,802
Discounts	1,419,493	1,466,434	1,514,927
Operating Expenses	1,331,689	1,375,727	1,421,221
Profit Transfers	\$ 6,668,596	\$ 6,889,120	\$ 7,116,936

BEER TAX

Revenue Description

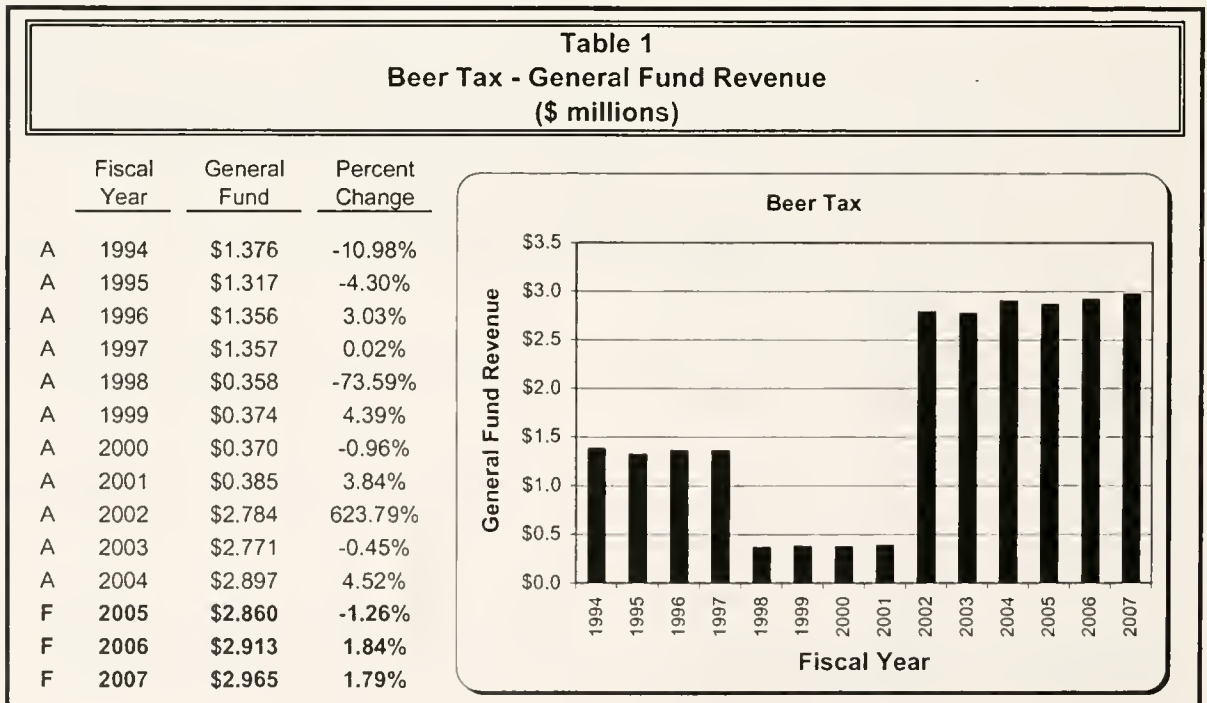
Section 16-1-406, MCA, directs the Department of Revenue to collect a tax on each barrel (a barrel consists of 31 gallons) of beer sold in Montana by a wholesaler at the rate shown below:

<u>Barrels Produced by a Brewer</u>	<u>Tax Rate Per Barrel</u>
Less than or equal to 5,000	\$1.30
5,001 to 10,000	\$2.30
10,001 to 20,000	\$3.30
Greater than 20,000	\$4.30

Beer tax revenues are distributed 76.74% to the state general fund and 23.26% to the Department of Public Health and Human Services. A small portion of beer tax revenue is transferred from the general fund to the tribes of the Blackfeet, Fort Peck, and Fort Belknap Reservations. These tribes have revenue sharing agreements with the state.

Historical and Projected Revenue

Table 1 shows historical and projected general fund revenue from the beer tax for FY 1994 through FY 2007.



The 1997 special session passed HB 166, decreasing the general fund share of beer tax revenue from 41.86% to 11.63%. This caused a large drop in general fund revenue for FY 1998. Increased general fund revenue for FY 2002 was due to HB 124, passed in the 2001 session. This measure raised the general fund share of beer tax revenue from 11.63% to 76.74%. The forecast projects beer tax revenue to drop in FY 2005 but increase in FY 2006 and FY 2007.

Forecast Methodology and Projection Calculation

The forecast is made in four steps. First, per capita consumption of beer is estimated. Second, state population (age 20 and over) and per capita consumption of beer are projected through FY 2007. Third, total collections are projected. Fourth, total collections are allocated to the general fund and those tribes with revenue sharing agreements.

Table 2 shows the calculation of the per capita consumption of beer in Montana from FY 1994 through FY 2004. Column three is the weighted average FY 2003 tax rate for beer. To obtain the average tax rate for beer, each tax rate is multiplied by the percent of beer subject to that tax rate.

Table 2							
Actual and Forecast Per Capita Consumption							
Fiscal Year	Total Beer Tax Collections	/	Average Beer Tax Rate	/	Population Age 20 and Over	= Per Capita Consumption in Barrels	% Change
A 1994	\$3,263,346	/	\$4.25	/	612,266	= 1.2541	
A 1995	\$3,215,598	/	\$4.25	/	622,454	= 1.2155	-3.08%
A 1996	\$3,329,868	/	\$4.25	/	628,525	= 1.2466	2.55%
A 1997	\$3,238,663	/	\$4.25	/	632,534	= 1.2047	-3.36%
A 1998	\$3,324,479	/	\$4.25	/	637,392	= 1.2272	1.87%
A 1999	\$3,443,466	/	\$4.25	/	643,296	= 1.2595	2.63%
A 2000	\$3,613,076	/	\$4.25	/	652,506	= 1.3029	3.44%
A 2001	\$3,614,271	/	\$4.25	/	661,618	= 1.2854	-1.34%
A 2002	\$3,673,818	/	\$4.25	/	670,416	= 1.2894	0.31%
A 2003	\$3,680,560	/	\$4.25	/	678,104	= 1.2771	-0.95%
A 2004	\$3,852,302	/	\$4.25	/	684,580	= 1.3241	3.68%
F 2005						1.2958	-2.14%
F 2006						1.3091	1.03%
F 2007						1.3225	1.03%

To calculate per capita beer consumption, total collections are divided by the weighted average tax rate and by population. Per capita consumption of beer in Montana was 1.3241 barrels in FY 2004. Per capita consumption for FY 2005 is forecast to be the average of per capita consumption for FY 2000 through FY 2004. Growth of per capita consumption in FY 2006 and FY 2007 is forecast to be the average change in per capita consumption from FY 2000 through FY 2004.

Table 3 gives a forecast calculation of general fund beer tax revenue through FY 2007. The consumption forecast is multiplied by population estimates and the average tax rate per barrel to get total tax collections.

Table 3 Forecast Total Collections						
Fiscal Year	Per Capita Consumption (Barrels)		Population Age 20 and Over		Weighted Average Tax	Total Collections
2005	1.2958	X	690,604	X	\$4.25	= \$3,803,142
2006	1.3091	X	696,153	X	\$4.25	= \$3,873,089
2007	1.3225	X	701,425	X	\$4.25	= \$3,942,514

Table 4 shows the general fund allocation of beer tax. Total collections are multiplied by 76.74%, the general fund allocation before revenue sharing payments to tribal governments. The tribal share is estimated to be 2% of the general fund allocation each year. This figure represents the approximate ratio of combined tribal population within the Blackfeet, Fort Peck and Fort Belknap Reservations to state population (all ages).

Table 4 Beer Tax Allocation for FY 2005 through FY 2007						
Fiscal Year	Total Collections		General Fund Allocation Percent	Dollars	Tribal Share	General Fund Revenue
F 2005	\$3,803,142	X	76.74%	= \$2,918,531	- \$58,371	= \$2,860,160
F 2006	\$3,873,089	X	76.74%	= \$2,972,208	- \$59,444	= \$2,912,764
F 2007	\$3,942,514	X	76.74%	= \$3,025,485	- \$60,510	= \$2,964,975

Projections of general fund collections are \$2.860 million in FY 2005, \$2.913 million in FY 2006, and \$2.965 million in FY 2007.

WINE TAX

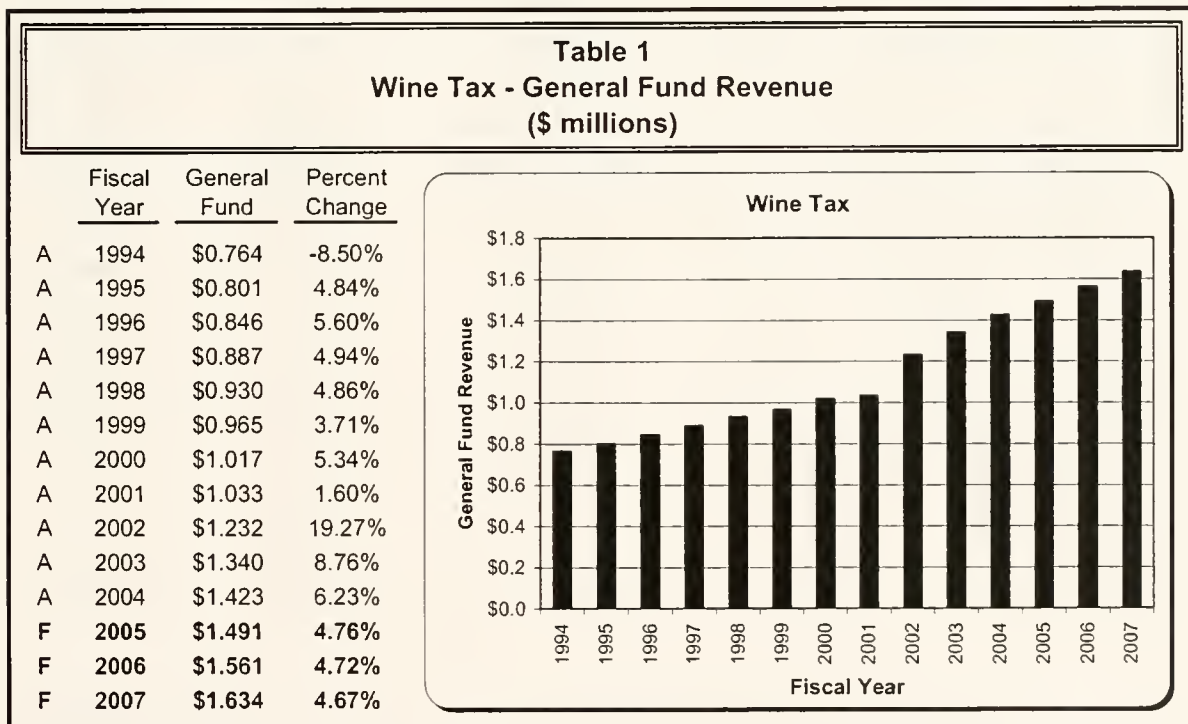
Revenue Description

Section 16-1-411, MCA, directs the Department of Revenue to collect a tax of 27 cents on each liter of table wine and 3.7 cents on each liter of hard cider imported by a distributor or the department. Revenues from the hard cider tax are insignificant (less than 0.08% of total collections in FY 2004) and thus are treated as wine tax revenues in the following analysis.

Wine tax revenues are distributed 69% to the state general fund and 31% to the Department of Public Health and Human Services. About 2% of the general fund wine tax revenue is allocated to tribes that have revenue sharing agreements with the state. Currently this includes the tribes of the Blackfeet, Fort Peck, and Fort Belknap Reservations.

Historical and Projected Revenue

Table 1 shows historical and projected general fund revenue from the wine tax for FY 1994 through FY 2007.



The forecast projects wine tax revenue to increase approximately 4.7% annually in FY 2005 through FY 2007. FY 2002 wine tax revenue increased 19.27%. This large

increase was due to HB 124, passed in the 2001 session, which increased the general fund share of wine tax revenue from 59% to 69%.

Forecast Methodology and Projection Calculation

The general fund share of the wine tax is prepared in three steps:

1. Estimate per capita consumption of wine for FY 2005 through FY 2007 using per capita consumption from FY 1994 through FY 2004.
2. Multiply the estimates of per capita consumption by population and the tax rate (\$0.27/liter) to obtain estimates of total collections through FY 2007.
3. Determine the wine tax allocation to the general fund.

Table 2 shows actual total wine tax collections, the tax rate, state population age 20 and older, per capita consumption, and percent change in per capita consumption for FY 1989 through FY 2004.

Table 2								
Per Capita Consumption of Wine (in liters)								
Fiscal Year	Total Collections	/	Tax	/	Population Age 20 and Over	=	Per Capita Consumption	Percent Change
1989	\$1,453,980	/	\$ 0.27	/	553,683	=	9.726	-7.70%
1990	\$1,404,764	/	\$ 0.27	/	559,846	=	9.293	-4.45%
1991	\$1,346,598	/	\$ 0.27	/	571,050	=	8.734	-6.02%
1992	\$1,433,011	/	\$ 0.27	/	585,317	=	9.068	3.82%
1993	\$1,360,770	/	\$ 0.27	/	599,363	=	8.409	-7.27%
1994	\$1,289,016	/	\$ 0.27	/	612,266	=	7.797	-7.27%
1995	\$1,360,600	/	\$ 0.27	/	622,454	=	8.096	3.83%
1996	\$1,440,310	/	\$ 0.27	/	628,525	=	8.487	4.84%
1997	\$1,503,390	/	\$ 0.27	/	632,534	=	8.803	3.72%
1998	\$1,600,500	/	\$ 0.27	/	637,392	=	9.300	5.65%
1999	\$1,661,112	/	\$ 0.27	/	643,296	=	9.564	2.83%
2000	\$1,767,654	/	\$ 0.27	/	652,506	=	10.033	4.91%
2001	\$1,786,403	/	\$ 0.27	/	661,618	=	10.000	-0.33%
2002	\$1,815,798	/	\$ 0.27	/	670,416	=	10.031	0.31%
2003	\$1,976,257	/	\$ 0.27	/	678,104	=	10.794	7.60%
2004	\$2,104,165	/	\$ 0.27	/	684,580	=	11.384	5.47%
2005							11.826	3.88%
2006							12.285	3.88%
2007							12.762	3.88%

The annual growth rate in per capita consumption for FY 2005 through FY 2007 is projected at 3.88%, which is the average annual growth rate from FY 1995 through FY 2004.

As shown in Table 3, forecasts for total wine tax collections are the product of estimated adult population, per capita consumption and the tax rate of \$0.27 per liter.

Table 3 Projected Wine Tax Collections FY 2005 through FY 2007						
<u>Fiscal Year</u>	<u>Population Age 20 and</u>		<u>Per Capita Consumption</u>		<u>Tax</u>	<u>Total Collections</u>
F 2005	690,604	X	11.83	X	\$0.27	= \$2,205,090
F 2006	696,153	X	12.28	X	\$0.27	= \$2,309,102
F 2007	701,425	X	12.76	X	\$0.27	= \$2,416,912

Table 4 shows the general fund allocation of projected wine tax revenues. The general fund receives 69% of the total revenue less revenue sharing agreement payments to the tribes. Tribal payments averaged 2% of general fund wine tax collections from FY 2000 through FY 2004. This percentage is used to estimate tribal payments for FY 2005 through FY 2007.

Table 4 Calculation of General Fund Wine Tax Allocation FY 2005 through FY 2007								
<u>Fiscal Year</u>	<u>Total Collections</u>		<u>General Fund Allocation Percent</u>		<u>Dollars</u>		<u>Tribal Refunds</u>	<u>General</u>
2005	\$2,205,090	X	69%	=	\$1,521,512	-	\$30,430	= \$1,491,082
2006	\$2,309,102	X	69%	=	\$1,593,281	-	\$31,866	= \$1,561,415
2007	\$2,416,912	X	69%	=	\$1,667,669	-	\$33,353	= \$1,634,316

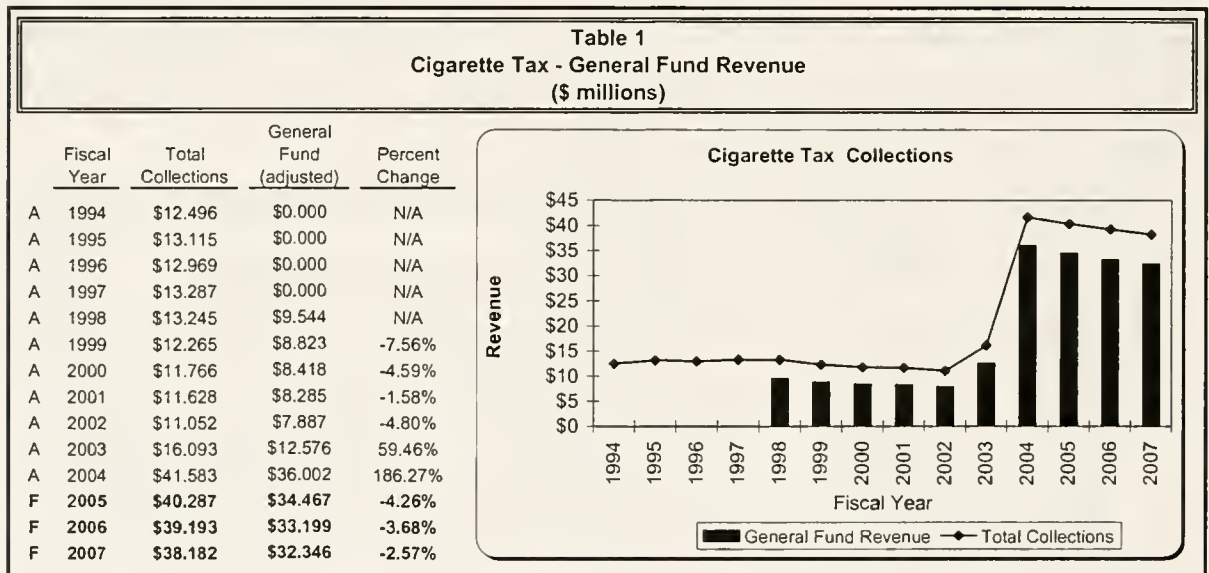
CIGARETTE TAX

Revenue Description

Section 16-11-111, MCA, specifies a tax of 70 cents on each pack of 20 cigarettes. If a pack contains more than twenty cigarettes, the tax is pro-rated by 1/20th of the 70-cent tax for each cigarette exceeding 20 cigarettes.

Historical and Projected Revenue

Table 1 shows historical and projected total and general fund collections from cigarette tax revenues, after tribal revenue sharing payments, for FY 1994 to FY 2007.



Prior to FY 1998, cigarette taxes were not allocated to the general fund. HB 166, (1997 session) distributed cigarette tax revenues, after tribal revenue sharing payments, 73.04% to the general fund; 15.85% to the Long-Range Building Program account; and 11.11% to the Department of Public Health and Human Services, as provided for in 16-11-119, MCA.

Beginning May 1, 2003, SB 407 (2003 session) increased the tax on cigarettes from \$0.18 to \$0.70 per pack. SB 407 also changed the distribution of cigarette taxes, effectively increasing the general fund portion from 73.04% of tax collections to 87.40%. Under SB 407, the Long-Range Building Program account receives 4.3% of cigarette tax revenue and the Department of Public Health and Human Services receives the greater of 8.3% or \$2.0 million. The tax increase under SB 407 explains the overall increase in cigarette tax revenue in FY 2003 and beyond. The tax increase, along with the change in distribution, explains the increase to general fund revenue in FY 2003 and subsequent years.

The forecast projects general fund revenue to decrease 4.26% in FY 2005, 3.68% in FY 2006, and 2.57% in FY 2007.

Forecast Methodology and Projection Calculation

The variables used in estimating cigarette tax revenues include: 1) Montana adult population; 2) per capita cigarette tax revenue; 3) estimated packs of cigarettes taxed, including the change in demand attributable to the increase in the tax rate; and 4) the Blackfeet, Fort Belknap, and Fort Peck tribal revenue sharing agreement payments.

For purposes of projecting the demand for packs of cigarettes, the analysis assumes that the tax increase of \$0.52 per pack will increase the price per pack of cigarettes by the same amount. For purposes of projecting demand, the price per pack of cigarettes prior to the tax increase was \$3.21 and now is estimated at \$3.73 (\$3.21 + \$0.52).

Population Growth

Table 2 shows the projected adult population, and percent change (growth) for FY 2005 through FY 2007.

Table 2 Projected Adult Population		
Fiscal Year	Adult Population ¹	% Change
A 2004	753,037	
F 2005	757,695	0.62%
F 2006	761,921	0.56%
F 2007	765,965	0.53%

¹ Source: Global Insight, Inc. Forecast of MT Population Age 15 and Over.

Cigarette Price Elasticity

Price elasticity is the consumption change response to a price change. Historic price elasticity for cigarettes and tobacco products has ranged between -0.40 and -0.55. A price elasticity of -0.40 means that a 10% increase in price will reduce demand or consumption by 4%.

For this analysis, a price elasticity of -0.44 is used in the consumption model to predict the impact of the \$0.52 tax increase on cigarette consumption. A price elasticity of -0.44 in the model means that a 16.2% price increase in cigarettes will decrease consumption by 7.13%¹, or approximately 0.14% for every one cent increase in price.

¹ (The additional tax of \$0.52 ÷ the base price of \$3.21 = 16.2% x price elasticity of -0.44 = -7.13%)

Historic Per Capita Cigarette Tax Collections

Table 3 shows actual per capita cigarette tax collections. Per capita tax collections are total tax collections divided by the adult population. Actual per capita consumption has declined since FY 1995. However, with the tax increase of 289% in May of FY 2003, per capita tax collections increased 44.4% in FY 2003 and 156.6% in FY 2004.

From FY 1995 to FY 2002 per capita collections declined from \$19.03 to \$14.91, an overall decrease of 21.3%, or an average annual decrease of 3.43%.

Table 3 Actual Per Capita Cigarette Tax Collections Fiscal Years 1994 through 2004					
Fiscal Year	Collections	Adult Population	% Change	Per Capita Collections	% Change
A 1995	\$ 13,114,640	689,259	1.73%	\$19.03	3.17%
A 1996	\$ 12,969,137	696,457	1.04%	\$18.62	-2.13%
A 1997	\$ 13,287,000	701,376	0.71%	\$18.94	1.73%
A 1998	\$ 13,245,000	707,240	0.84%	\$18.73	-1.14%
A 1999	\$ 12,265,347	714,269	0.99%	\$17.17	-8.31%
A 2000	\$ 11,766,271	724,323	1.41%	\$16.24	-5.40%
A 2001	\$ 11,628,458	733,465	1.26%	\$15.85	-2.40%
A 2002	\$ 11,052,174	741,490	1.09%	\$14.91	-5.98%
Ave. Annual Per Capita Change 1995 - 2002					-3.43%
A 2003	\$ 16,093,023	747,936	0.87%	\$21.52	44.35%
A 2004	\$ 41,582,823	753,037	0.68%	\$55.22	156.64%

Projected Per Capita Tax Growth – Without SB 407

Assuming SB 407 had not affected cigarette tax revenue, continuing the trend in per capita collections forward creates a baseline for applying the cigarette price elasticity, and estimating future revenue.

Table 4 shows the projected per capita trend for FY 2005 through FY 2007 without considering the impact of SB 407. The historical average annual decrease of 3.43% is used to project FY 2005 per capita collections. The forecast assumes that the decrease in per capita collections will level slightly from the historical annual average, and are projected at 95% of the prior year growth. The per capita growth rate is -3.26% in FY 2006 and -3.09% in FY 2007.

Table 4 Projected Per Capita Tax Growth Without SB 407 Fiscal Years 2005 to 2007				
Fiscal Year	Baseline Growth Rate	Adjustment Factor		Per Capita Growth Rate
F 2005	-3.43%	x	0.00	= -3.43%
F 2006	-3.43%	x	0.95	= -3.26%
F 2007	-3.26%	x	0.95	= -3.09%

It is estimated that approximately 64.39 million packs of cigarettes would have been taxed in FY 2004 if the price per pack had remained at \$3.21, the price prior to tax increase.² As shown in Table 5, the combined impacts of population growth and the decrease in per capita consumption is an overall decrease of 2.83% ((100.62% x 96.57%)-1) in FY 2005, and a decrease of 2.72% in FY 2006 and 2.58% in FY 2007. The right-hand side of Table 5 shows that applying the combined rate of change each year makes the estimate of cigarette packs before the tax increase 62.57 million in FY 2005, 60.87 million in FY 2006, and 59.30 million in FY 2007.

Table 5 Projected Growth - Cigarette Consumption Fiscal Years 2005 - 2007					
Fiscal Year	Population Growth	Per Capita Consumption	Combined Growth	Packs (millions)	
				Prior to Tax Increase	Percent Change
F 2004				64.39	
F 2005	0.62%	-3.43%	-2.83%	62.57	-2.83%
F 2006	0.56%	-3.26%	-2.72%	60.87	-2.72%
F 2007	0.53%	-3.09%	-2.58%	59.30	-2.58%

Projected Per Capita Tax Collections – With SB 407

The number of taxed cigarette packs with SB 407 is forecast by adjusting the number of packs that would have been taxed without any change in the price per pack by the estimated change in consumption of -7.13% due to the tax increase. Table 6 shows that with the estimated change in consumption, packs of cigarette are forecast at 58.11 million in FY 2005, 56.53 million in FY 2006, and 55.07 million in FY 2007.

Table 6 Estimated Cigarette Consumption Fiscal Years 2004 through 2007			
Fiscal Year	Packs (Millions)		
	Prior to Tax Increase	% Change Packs	After Tax Increase
F 2005	62.57	-7.13%	58.11
F 2006	60.87	-7.13%	56.53
F 2007	59.30	-7.13%	55.07

² This is the estimated number of FY 2004 cigarette packs sold adjusted by the cigarette price elasticity.

Wholesaler Discounts

The excise tax on cigarettes is imposed on retail consumers, but is collected by wholesale or retail vendors. Wholesalers that purchase insignias from the state are allowed a discount to defray the cost of affixing the insignia, and the cost of pre-collecting and remitting the tax to the state. The discount is 1.66% for the first 2,580 cartons per month, 1.11% for the next 2,580 cartons per month, and 0.083% for purchases over 5,160 cartons per month.

Based on FY 2004 information, it is estimated that wholesaler discounts are approximately 0.956% of total collections each year. This is \$388,727 for FY 2005, \$378,167 for FY 2006, and \$368,413 for FY 2007.

Tribal Revenue Sharing Agreements

There are three types of arrangements for cigarette taxes with the seven reservations in Montana:

- 1) The Northern Cheyenne, Rocky Boy, and Crow Reservations have a tax-free quota agreement with the state.
- 2) The Flathead Reservation abides by the tax-free quota law with no specific agreement with the state.
- 3) The Blackfeet, Fort Belknap, and Fort Peck Reservations have a revenue sharing agreement with the state.

Wholesalers receive a refund for taxes pre-collected on cigarettes sold to tribal members on an Indian reservation that utilize the tax-free quota system.

Under the revenue sharing agreements, tribal revenue payments are calculated by multiplying the number of tribal members living within the boundaries of each reservation by 150% of the per capita cigarette collection amounts in the previous fiscal year. For example, using the FY 2003 per capita amount of \$17.70 (this figure is based on total population, whereas projected growth used in this analysis uses adult population), if a reservation had a tribal population of 1,000; the calculation for calendar year 2004 would be $1,000 \times \$17.70 \times 150\%$ for a total of \$26,550.

As per capita collections increase with the tax rate change, the revenue sharing payments also increase relatively. However, since tribal payments are made on a calendar year basis, the fiscal year payments made to the tribal governments lag fiscal year collections slightly. Revenue sharing tribal payments are estimated at \$851,000 for FY 2005, \$1.208 million in FY 2006, and \$1.172 million in FY 2007.

Revenue Calculation

Table 7 shows the calculation of general fund revenue from the cigarette tax for FY 2005 through FY 2007. The calculation first estimates taxes by multiplying the estimated number of taxable cigarette packs (from Table 6) by the tax rate of \$0.70. Estimated wholesaler discounts and tribal payments are then subtracted to yield net tax collections for distribution. Last, general fund revenue is forecast by multiplying net tax collections by the general fund share.

Estimated general fund cigarette tax revenues total \$34.5 million in FY 2005, \$33.2 million in FY 2006, and \$32.3 million in FY 2007.

Table 7			
Calculation of General Fund Cigarette Tax Revenue			
Description	FY2005	FY2006	FY2007
Estimated Number of Packs	58,108,119	56,529,536	55,071,537
Multiply by Tax Rate	\$ 0.70	\$ 0.70	\$ 0.70
Estimated Taxes	\$ 40,675,683	\$ 39,570,675	\$ 38,550,076
Subtract Est. Wholesaler Discounts	388,727	378,167	368,413
Subtract Est. Tribal Payments	850,721	1,207,582	1,172,325
Net Tax Collections for Distribution	\$ 39,436,235	\$ 37,984,926	\$ 37,009,337
Multiply by General Fund Share	87.40%	87.40%	87.40%
Total to General Fund	\$ 34,467,269	\$ 33,198,825	\$ 32,346,161

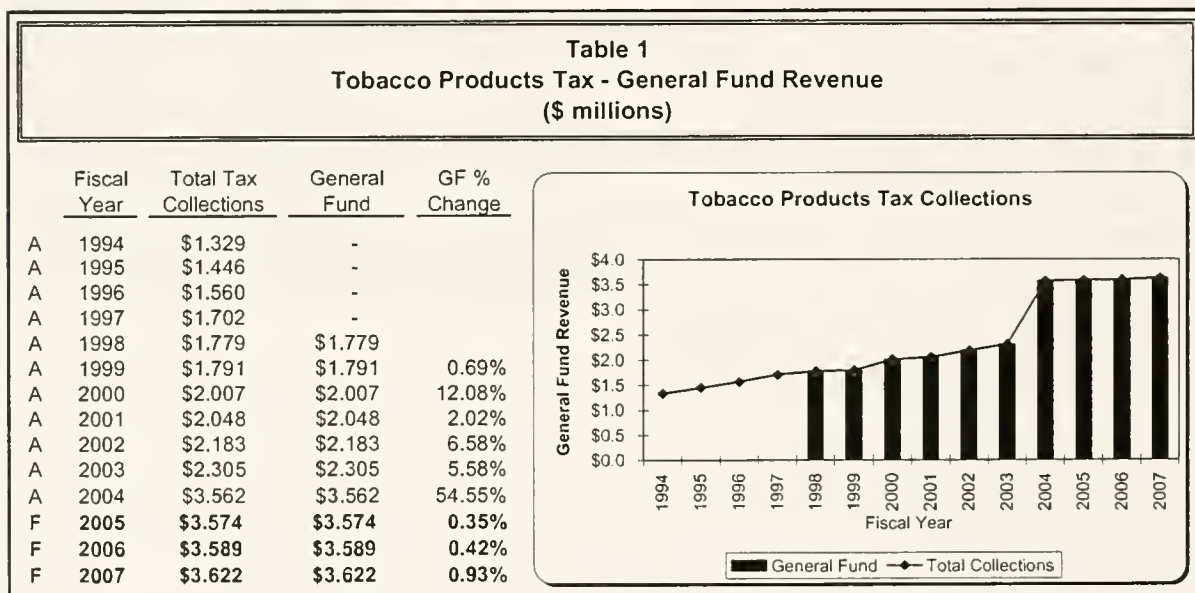
TOBACCO PRODUCTS TAX

Revenue Description

Section 16-11-202, MCA, directs the Department of Revenue (DOR) to collect a tax of 35 cents an ounce on moist snuff and 25% of the wholesale price of all other tobacco products. Tobacco products destined for retail sale and consumption outside Montana are not subject to this tax. The general fund receives 100% of the tobacco products tax revenue after distribution to tribes that have revenue sharing agreements.

Historical and Projected Revenue

Table 1 shows both historical and projected total tax collections and general fund revenue from the tobacco tax for FY 1994 through FY 2007.



Prior to FY 1998, tobacco taxes were not allocated to the general fund. Under the provisions of HB 166 (1997 session) tobacco tax revenues, after tribal revenue sharing payments, are distributed 100% to the general fund.

Beginning May 1, 2003, SB 407 (2003 session) changed the tax on moist snuff from 12.5% of the wholesale price to \$0.35 per ounce, an effective increase of \$0.07 per ounce. SB 407 also increased the tax on all other tobacco from 12.5% of the wholesale price to 25% of the wholesale price. The tax increases under SB 407 explain the overall increase in tobacco tax revenue in FY 2003 and FY 2004.

The forecast projects general fund revenue to increase 0.35% in FY 2005, 0.42% in FY 2006, and 0.93% in FY 2007.

Forecast Methodology and Projection Calculation

Since moist snuff and all other tobacco products now have different tax bases (ounces for moist snuff and wholesale price for other tobacco products), the revenue estimate examines each tax base separately.

Common variables used in estimating tobacco tax revenues for both moist snuff and all other tobacco products are:

1. Montana adult population
2. The change in demand attributable to the increase in the tax rate
3. Per capita collections of tobacco tax revenue

Because SB 407 changed the tax on moist snuff from a tax on wholesale price to a per ounce tax, future collections will no longer increase due to snuff price increases. This is significant because historic growth in collections was almost entirely attributable to increases in the snuff price. Therefore, in addition to the aforementioned variables, to mitigate the historic growth due to price increases, estimated moist snuff consumption is projected based on collections adjusted for inflation.

The forecast assumes that moist snuff and other tobacco products have identical growth patterns. This assumption is necessary because actual consumption data was not tracked for tobacco products prior to SB 407; only the wholesale revenue subject to tax was tracked. National price indices show similar growth for both snuff and all other tobacco products.

Population Growth

Table 2 shows the projected adult population, and percent change (growth) for FY 2005 through FY 2007.

Tobacco Products Price Elasticity

Price elasticity is the consumption change response to a price change. Historic price elasticity for cigarettes and tobacco products has ranged between -0.40 and -0.55. A price elasticity of -0.40 means that a 10% increase in price will reduce demand or consumption by 4%. For this analysis, a price elasticity of -0.44 is used to predict the SB 407 tax increase impact on demand for tobacco products.

This analysis assumes that the tax increase will raise the wholesale price of other tobacco products, or retail price per ounce of moist snuff, by the same amount.

Table 2		
Projected Adult Population		
FY 2005 to FY 2007		
Fiscal Year	Adult Population¹	% Change
A 2004	753,037	
F 2005	757,695	0.62%
F 2006	761,921	0.56%
F 2007	765,965	0.53%

¹ Source: Global Insight, Inc. Forecast of MT Population Age 15 and Over.

Historical Per Capita Tax Collections

Table 3 shows historical Montana adult population and adult per capita tobacco product tax collections. Historic per capita collections are total tax collections divided by adult population. As the top portion of Table 3 shows, per capita tobacco product tax collections have increased steadily since FY 1994. With the tax increase in May of FY 2003, per capita collections increased 52.57% in FY 2004.

Prior to the tax increase in FY 2003, per capita collections from FY 1994 through FY 2002 increased from \$1.96 to \$3.01 for an overall change of 53%. However, included in this growth were payments that tobacco companies began making in FY 2000 under the tobacco settlement. The tobacco settlement increased the wholesale price of tobacco products significantly in FY 2000. Because this growth from FY 1999 to FY 2000 was an unusual change, it was excluded in calculating the historical average annual per capita collection percentage.

The change in per capita collections from FY 1994 through FY 2002, excluding FY 2000, was 39.2%, or an average annual increase of 4.84%.

In FY 2004, other tobacco product tax collections were approximately 26% of the tobacco products tax collections, or \$0.9 million. Moist snuff tax collections made up approximately 74% of the total tax collections, or \$2.7 million.

Table 3 Per Capita Tobacco Tax Collections FY 1994 through FY 2004					
Fiscal Year ¹	Total Collections	Adult Population ²	% Chg.	Per Capita Collections	% Chg.
A 1994	\$ 1,328,908	677,511		\$1.96	
A 1995	\$ 1,446,101	689,259	1.73%	\$2.10	6.96%
A 1996	\$ 1,559,886	696,457	1.04%	\$2.24	6.75%
A 1997	\$ 1,702,000	701,376	0.71%	\$2.43	8.35%
A 1998	\$ 1,801,083	707,240	0.84%	\$2.55	4.94%
A 1999	\$ 1,817,971	714,269	0.99%	\$2.55	-0.06%
A 2000	\$ 2,042,241	724,323	1.41%	\$2.82	10.78%
A 2001	\$ 2,097,590	733,465	1.26%	\$2.86	1.43%
A 2002	\$ 2,228,524	741,490	1.09%	\$3.01	5.09%
Ave. Annual Per Capita Change 1994 - 1999 & 2001 - 2002					4.84%
A 2003	\$ 2,360,471	747,936	0.87%	\$3.16	5.01%
A 2004	\$ 3,625,893	753,037	0.68%	\$4.82	52.57%

¹ FY 2000 was first year of Tobacco Settlement Payments
² Source: Global Insight, Inc. Forecast of MT Population Age 15 and Over.
³ Total tax collections in this table includes tribal collections (Table 1 does not)

Projected Per Capita Tax Collections – Without SB 407

Assuming SB 407 had *not* affected tobacco tax revenue, continuing the trend in per capita collections forward creates a baseline for applying the tobacco product elasticity and estimating future revenue.

Table 4 shows the projected per capita trend for FY 2005 to FY 2007 without considering the impact of SB 407. The historical average annual change of 4.84% is used to project FY 2005 per capita collections. The forecast assumes that growth in per capita collections in FY 2006 and FY 2007 will level slightly from the historic annual average, and are projected at 95% of the prior year growth, which is 4.60% and 4.37% respectively.

Table 4 Projected Per Capita Tax Growth without SB 407 FY 2005 to FY 2007					
Fiscal Year	Baseline Growth Rate		Adjustment Factor		Per Capita Growth Rate
F 2005	4.84%	x	0.00	=	4.84%
F 2006	4.84%	x	0.95	=	4.60%
F 2007	4.60%	x	0.95	=	4.37%

Other Tobacco Products Tax Base

The amount of other tobacco products taxed on wholesale price is forecast by estimating the wholesale amount of tobacco products that would have been taxed without any change in price. These amounts are then adjusted for the estimated impacts on consumption (elasticity) due to the increased price attributable to the tax increase.

Change in Consumption of Other Tobacco Products Prior to Tax Increase

Table 5 shows estimated adult population (Table 2) growth, per capita tax growth (Table 4), and the combined population and per capita growth rate. The combined growth rate¹ is used to estimate sales that would have been taxed without an increase in price (tax). The combined impact of population growth and per capita consumption is an overall increase of 5.49% in FY 2005, 5.18% in FY 2006, and 4.92% in FY 2007.

Table 5 Projected Growth FY 2005 to FY 2007			
Fiscal Year	Population Growth	Per Capita Consumption	Combined Growth
F 2005	0.62%	4.84%	5.49%
F 2006	0.56%	4.60%	5.18%
F 2007	0.53%	4.37%	4.92%

These growth rates are then applied to the estimated wholesale amount of other tobacco products sold without the changes due to SB 407. Using FY 2004 collections, adjusted for elasticity, it is estimated that without a change in price (tax), the estimated wholesale amount of other tobacco products sold would have been \$4.047 million. This is the \$0.9 million of FY 2004 taxes collected plus wholesalers discounts, divided by the 25% tax rate, divided by the inverse of the elasticity impact, or .9511 (1 – 4.89%).

¹ The projected growth is made by dividing one plus the percent change in per capita collections, by one plus the inflation factor or index, and subtracting one. For instance, in FY 2005 the adjustment calculation is: $((1 + 0.62\%) \div (1 + 4.84\%) - 1) = 5.49\%$

As Table 6 shows, the wholesale price of other tobacco products is forecast by applying the combined growth rate from Table 5 to the taxable sales. The wholesale price of other tobacco products sold prior to the SB 407 tax increase is estimated at \$4.269 million in FY 2005, \$4.490 million in FY 2006, and \$4.712 million in FY 2007.

Table 6 Other Tobacco Tax Base Prior to SB 407 (\$ millions)		
Fiscal Year	Prior to Tax Increase*	% Change
F 2004	\$4.047	
F 2005	\$4.269	5.49%
F 2006	\$4.490	5.18%
F 2007	\$4.712	4.92%

*Wholesale Price

Other Tobacco Products Tax Base after SB 407

At any price level, the increase in tax from 12.5% to 25% of wholesale price equates to a price increase of 11.11%. A price elasticity of -0.44 for other tobacco products reduces consumption by 4.89%, which is calculated by multiplying the 11.11% price change by the elasticity of -0.44 ($11.11\% \times -0.44 = -4.89\%$).

Table 7 shows the increase in price due to the higher tax rate in SB 407. The wholesale price of other tobacco product sales is projected at \$4.060 million in FY 2005, \$4.271 million in FY 2006, and \$4.481 million in FY 2007.

Table 7 Other Tobacco Tax Base with SB 407 FY 2005 through FY 2007 (\$ millions)			
Fiscal Year	-----Other Tobacco Products (Dollars)-----		
	Prior to Tax Increase	Elasticity % Change	After Tax Increase
F 2005	\$4.269	-4.89%	\$4.060
F 2006	\$4.490	-4.89%	\$4.271
F 2007	\$4.712	-4.89%	\$4.481

Moist Snuff Tax Base

Moist snuff ounces are forecast by estimating the number of ounces that would have been taxed without any change in price. However, since the tax on moist snuff prior to SB 407 was assessed on wholesale price, historical consumption (ounces) is forecast by using historical tax collections adjusted by a producer price index to mitigate the growth in tax collections due to price increases.

Once historical consumption is estimated, it is then adjusted for the estimated impacts on consumption (elasticity) due to the increased price attributable to the tax increase.

Consumption Change in Moist Snuff Prior to SB 407 Tax Increase

Table 8 shows the producer price index for snuff and the percent change from FY 1994 through FY 2002. A producer price index shows the change in the manufacturing price of a product and is an indication of inflation. The producer price index is used to neutralize the increase in tax due to raises in the price of the product.

An average annual change is used to forecast the index into the future. However, as was done with per capita collections, since FY 2000 saw an unusually high increase attributable to the first year of tobacco settlement payments, it was excluded in calculating the average annual change.

Table 8 Snuff - Producer Price Index Bureau of Labor Statistics			
Fiscal Year ¹	BLS Index ²	Change	% Chg.
1994	288.0		
1995	313.2	25.2	8.75%
1996	322.2	9.0	2.87%
1997	332.9	10.7	3.32%
1998	349.8	16.9	5.08%
1999	381.5	31.7	9.06%
2000	420.4	38.9	10.20%
2001	439.1	18.7	4.45%
2002	460.5	21.4	4.87%
Ave. Annual Change 1994-1999 & 2001-2002			5.60%
¹ FY 2000 Year 1 of Tobacco Settlement Payments			
² Measurements taken in June of each year			

The forecast assumes that once inflation is removed, the change in tax collections is attributable to a change in consumption. The top of Table 9 shows the annual change in per capita collections from Table 3, the annual change in the producer price index from Table 8, and the annual change in per capita collections adjusted for price increases.² The adjusted collection percent is the estimated change in snuff consumption.

Highlighted in Table 9, the historical average annual change of 5.60% is used to project the FY 2005 price index. The price index in FY 2006 and FY 2007 is projected at 95% of the prior years growth, which is 5.32% and 5.05% respectively.

As shown on the bottom-right of Table 9, using the estimated change in per capita collections and adjusting by the estimated change in the price index yields an estimated snuff consumption decrease of 0.75% in FY 2005, 0.71% in FY2006, and 0.68% in FY 2007.

Table 9 Price Adjusted Per Capita Collections			
----- Percent Change -----			
Fiscal Year ¹	Per Capita Collections	BLS Index	Adjusted Collections
1995	6.96%	8.75%	-1.79%
1996	6.75%	2.87%	3.88%
1997	8.35%	3.32%	5.02%
1998	4.94%	5.08%	-0.13%
1999	-0.06%	9.06%	-9.12%
2000	10.78%	10.20%	0.58%
2001	1.43%	4.45%	-3.02%
2002	5.09%	4.87%	0.22%
Average Annual Change 1994-1999 & 2001-2002			
	4.84%	5.60%	-0.75%
2005	4.84%	5.60%	-0.75%
2006	4.60%	5.32%	-0.71%
2007	4.37%	5.05%	-0.68%
¹ FY 2000 was first year of Tobacco Settlement Payments			

²The adjustment is made by dividing one plus the percent change in per capita collections, by one plus the inflation factor or index, and subtracting one. For instance, in FY 2002 the adjustment calculation is: $((1 + 5.09\%) \div (1 + 4.87\%) - 1) = 0.22\%$.

Using actual FY 2004 collections, adjusted for elasticity, it is calculated that, without a change in price (tax), estimated ounces of moist snuff would have been 7.959 million in FY 2004. This figure is derived by adding wholesaler discounts to FY 2004 tax collections of \$2.7 million, dividing by the \$0.35 tax rate, then dividing by the inverse of the elasticity impact, or 0.9896 ($1 - 1.04\%$).

As shown in Table 10, ounces of moist snuff are forecast by applying the growth rates from Table 9 to the prior years total. Consumption of moist snuff ounces is estimated at 7.902 million in FY 2005, 7.849 million in FY 2006, and 7.798 million in FY 2007.

Table 10
Moist Snuff Tax Base - Ounces
(\$ millions)

Fiscal Year	Prior to Tax Increase	% Change
F 2004	7.959	
F 2005	7.902	-0.71%
F 2006	7.849	-0.68%
F 2007	7.798	-0.64%

Moist Snuff Tax Base after SB 407

For purposes of projecting demand, the retail price per ounce of moist snuff prior to the tax increase was \$2.95, and now, is estimated at \$3.02 ($\$2.95 + \0.07) per ounce. (Although moist snuff is typically sold in 1.2-ounce cans, demand is projected for each ounce because the tax is calculated on a per ounce basis.) The tax increase of \$0.07 is an increase of 2.37% ($\$0.07 \div \2.95). A price elasticity of demand for moist snuff of -0.44 in the model means that, with a base price prior to the tax increase of \$2.95, an increase of \$0.07 will decrease consumption by 1.04% ($2.37\% \times -0.44 = -1.04\%$).

As Table 11 shows, with the increase in price due to the higher tax rate per ounce, ounces of moist snuff sold are forecast at 7.820 million in FY 2005, 7.767 million in FY 2006, and 7.717 million in FY 2007.

Table 11
Estimated Moist Snuff Consumption
FY 2005 through FY 2007
(\$ millions)

Fiscal Year	-----Moist Snuff Ounces Sold-----		
	Prior to Tax Increase	% Change Ounces	After Tax Increase
F 2005	7.902	-1.04%	7.820
F 2006	7.849	-1.04%	7.767
F 2007	7.798	-1.04%	7.717

Wholesaler Discounts

The excise tax on tobacco products is imposed on retail consumers, but is collected by wholesalers. Wholesalers are allowed a discount equal to 2.5% of total tax collections to defray collection and administrative costs.

Wholesaler discounts for other tobacco products are estimated at \$25,377 for FY 2005, \$26,693 in FY 2006, and \$28,008 in FY 2007. Wholesaler discounts for moist snuff are estimated at \$68,423 for FY 2005, \$67,960 in FY 2006, and \$67,523 in FY 2007.

Tribal Revenue Sharing Agreements

There are three types of arrangements for tobacco taxes with the seven reservations in Montana:

- 1) The Northern Cheyenne, Rocky Boy, and Crow Reservations have a tax-free quota agreement with the state.
- 2) The Flathead Reservation abides by the tax-free quota law with no specific agreement with the state.
- 3) The Blackfeet, Fort Belknap, and Fort Peck Reservations have a revenue sharing agreement with the state.

Wholesalers receive a refund for taxes pre-collected on tobacco products sold to tribal members on an Indian reservation that utilize the tax-free quota system.

Under the revenue sharing agreements, tribal revenue payments are calculated by multiplying the number of tribal members living within the boundaries of each reservation by 150% of the per capita tobacco tax collection amounts in the previous fiscal year. For example, using the FY 2003 per capita amount of \$2.48 (this figure is based on total population, whereas projected growth used in this analysis uses adult population), if a reservation had a tribal population of 1,000, the calculation for calendar year 2004 would be $1,000 \times \$2.48 \times 150\%$ for a total of \$3,720.

As per capita collections increase with the tax rate change, the revenue sharing payments also increase relatively. However, since tribal payments are made on a calendar year basis, the fiscal year payments made to the tribal governments lag fiscal year collections slightly. Tobacco tax revenue sharing tribal payments are estimated at \$84,262 for FY 2005, \$102,529 in FY 2006, and \$103,452 in FY 2007.

General Fund Revenue Calculation

Table 12 on the following page shows the calculation of tobacco tax revenue for FY 2005 through FY 2007. The calculation first estimates taxes on other tobacco products by multiplying the estimated wholesale price of other tobacco products sold from Table 7 by the tax rate of 25.0%.

The 2.5% wholesaler discounts are then subtracted to yield net other tobacco tax collections of \$0.990 million in FY 2005, \$1.041 million in FY 2006, and \$1.092 million in FY 2007.

Next, moist snuff taxes are projected by multiplying the estimated number of ounces from Table 11 by the tax rate of \$0.35. The 2.5% wholesaler discounts are then subtracted to yield net moist snuff tax collections of \$2.668 million in FY 2005, \$2.650 million in FY 2006, and \$2.633 million in FY 2007.

Last, general fund revenue is determined by subtracting estimated tribal payments from total tobacco products tax revenue.

Estimated general fund tobacco tax revenues total \$3.57 million in FY 2005, \$3.59 million in FY 2006, and \$3.62 million in FY 2007, as shown in Table 12.

Table 12 Calculation of General Fund Tobacco Products Tax			
Other Tobacco Products			
<u>Description</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Estimated Wholesale Price Other Products	\$4,060,384	\$4,270,880	\$4,481,202
Multiply by Tax Rate (25% of wholesale)	25.0%	25.0%	25.0%
Estimated Taxes	\$1,015,096	\$1,067,720	\$1,120,300
Subtract Est. Wholesaler Discounts (2.5%)	25,377	26,693	28,008
Other Tobacco Tax Collections	<u>\$ 989,718</u>	<u>\$1,041,027</u>	<u>\$1,092,293</u>
Moist Snuff			
<u>Description</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Estimated Ounces of Moist Snuff	7,819,766	7,766,835	7,716,892
Multiply by Tax Rate (per ounce)	\$ 0.35	\$ 0.35	\$ 0.35
Estimated Taxes	\$2,736,918	\$2,718,392	\$2,700,912
Subtract Est. Wholesaler Discounts (2.5%)	68,423	67,960	67,523
Moist Snuff Tax Collections	<u>\$2,668,495</u>	<u>\$2,650,433</u>	<u>\$2,633,389</u>
Total Tobacco Products			
<u>Description</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Moist Snuff Tax Collections	\$2,668,495	\$2,650,433	\$2,633,389
Other Tobacco Tax Collections	989,718	1,041,027	1,092,293
Total Tobacco Tax Collections	<u>\$3,658,213</u>	<u>\$3,691,460</u>	<u>\$3,725,682</u>
Less Tribal Payments	84,262	102,529	103,452
General Fund Tobacco Revenue	<u>\$3,573,951</u>	<u>\$3,588,931</u>	<u>\$3,622,230</u>

TOBACCO SETTLEMENT REVENUE

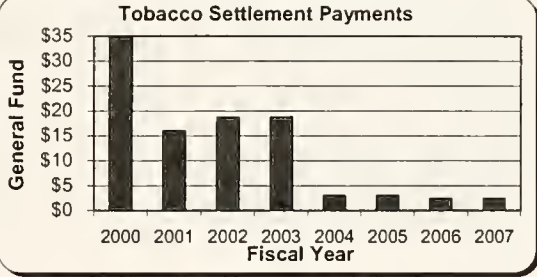
Revenue Description

In 1998, Montana, along with 45 other states, signed a settlement agreement with major tobacco companies that resulted in Montana receiving an estimated \$832 million through the year 2025. Payments are provided annually beginning in FY 2000. The initial schedule of payments provided for under the settlement agreement is subject to change depending on adjustment criteria specified in the agreement.

Historical and Projected Tobacco Settlement Funds

Table 1 shows historical and forecast tobacco settlement funds for FY 2000 through FY 2007. The terms of the original agreement provided for payments to begin in FY 1998. Montana did not receive its first payment until FY 2000.

Fiscal Year	Total Collections	Percent Change	General Fund	Percent Change
A 2000	\$34.804		\$34.804	
A 2001	\$26.640	-23.46%	\$15.989	-54.06%
A 2002	\$31.079	16.66%	\$18.647	16.63%
A 2003	\$31.166	0.28%	\$18.700	0.28%
A 2004	\$26.669	-14.43%	\$2.934	-84.31%
F 2005	\$26.435	-0.88%	\$2.908	-0.88%
F 2006	\$21.531	-18.55%	\$2.368	-18.55%
F 2007	\$21.264	-1.24%	\$2.339	-1.24%



Fiscal Year	General Fund (millions)
2000	\$34.804
2001	\$15.989
2002	\$18.647
2003	\$18.700
2004	\$2.934
2005	\$2.908
2006	\$2.368
2007	\$2.339

The forecast payments are decreasing because cigarette consumption has fallen, and there are concerns over changes in market share between the tobacco settlement participating and non-participating companies.

The electorate in the November 2000 election passed Montana Constitutional Amendment 35, which required no less than 40% of tobacco settlement money to be deposited in a trust fund, with the remaining money deposited in the state general fund. The trust fund was established to provide a permanent source of revenue to fund the costs that the state incurs in programs for tobacco disease prevention, and in providing benefits, services, or coverage of health care needs. Nine-tenths of the interest and income from the trust fund may be appropriated; one-tenth of the interest and income derived from the trust fund on or after January 1, 2001, is deposited in the trust fund. The principal of the trust fund and one-tenth of the interest and income deposited in the trust fund shall remain forever inviolate unless appropriated by a vote of two-thirds of the members of each house of the legislature.

The electorate in the November 2002 election passed Initiative 146 (I-146), which requires the tobacco settlement payments received after June 30, 2003, to be deposited 32% in a state special revenue account for tobacco prevention; 17% in a state special revenue account for health insurance benefits; no less than 40% in the trust fund; and the remaining money to be deposited in the state general fund.

Table 2 shows the estimated tobacco payment distributions to each fund for FY 2005 through FY 2007.

Table 2 Estimated Tobacco Settlement Payment Distributions FY 2005 Through FY 2007			
----- Fiscal Year 2005 -----			
Payment	Fund	Distribution	Amount
Forecast \$26.435	General Fund	11%	\$2.908
	Tobacco Trust Fund	40%	10.574
	Tobacco Prevention Account	32%	8.459
	Health Insurance Benefits Acc.	17%	4.494
	Total	100%	\$26.435
----- Fiscal Year 2006 -----			
Payment	Fund	Distribution	Amount
Forecast \$21.531	General Fund	11%	\$2.368
	Tobacco Trust Fund	40%	8.612
	Tobacco Prevention Account	32%	6.890
	Health Insurance Benefits Acc.	17%	3.660
	Total	100%	\$21.531
----- Fiscal Year 2007 -----			
Payment	Fund	Distribution	Amount
Forecast \$21.264	General Fund	11%	\$2.339
	Tobacco Trust Fund	40%	8.505
	Tobacco Prevention Account	32%	6.804
	Health Insurance Benefits Acc.	17%	3.615
	Total	100%	\$21.264

Forecast Methodology and Projected Calculation

The Master Settlement Agreement, referred to as “the tobacco settlement”, or “the tobacco agreement,” provides for complex methods and formulas to calculate state payments. There are 13 clauses in the tobacco settlement that determine the allocations, offsets, reductions and adjustments to the payment due from the Original Participating Manufacturers (OPM), and from Subsequent Participating Manufacturers (SPM).

There are five main calculations used to determine Montana’s annual payments:

- 1) The volume adjustment to the base payment;
- 2) The volume adjustment to the base operating income;
- 3) The Non-Participating Manufacturers (NPM) Adjustment;
- 4) Previously settled states reduction; and
- 5) Subsequent Participating Manufacturers’ payments.

Each of these calculations involve sub-calculations to forecast Montana’s tobacco settlement payments. There are two main variables used in calculating tobacco settlement payments: inflation and cigarette sales volume.

Inflation Adjustment Rate

The inflation adjustment used in these calculations is the larger of 3% or the current year CPI, as set forth in the agreement. Annual inflation adjustments are cumulative, building from one year to the next. This estimate assumes an annual inflation rate of 3% compounded annually for the forecast period, which is the minimum inflation adjustment.

Volume Adjustment

Volume Adjustment Part 1 - In the event the aggregate number of cigarettes shipped in, or to, the fifty United States, the District of Columbia, and Puerto Rico by the Original Participating Manufactures (OPM) in the applicable year is greater or less than 475,656,000,000 cigarettes (the “base volume”), the applicable base payment is increased or decreased by the formulas set forth in the Master Settlement Agreement. This estimate assumes that the aggregate number of cigarettes shipped is less than the “base volume.”

Volume Adjustment Part 2 - In the event that aggregate operating income from sales of Original Participating Manufacturers' cigarettes for the applicable year is greater than the “base operating income” adjusted for inflation, there is a volume adjustment increase to the applicable payment. This estimate assumes that the operating income will be less than the base operating income adjusted for inflation; hence, there is no volume adjustment part 2 for FY 2005 through FY 2007.

Other Adjustments

There are three other adjustments. The first is a reduction in the base payment due to other states having previously settled with the manufacturers outside of the Master Settlement Agreement. The second is due to Subsequent Participating Manufacturers' payments. The third is the Non-Participating Manufacturers (NPM) Adjustment.

Summary of Tobacco Settlement Payments

Table 3 shows a summary of the calculations made to determine Montana's estimated tobacco settlement payments for FY 2005 through FY 2007. Subsequent sections of this forecast will detail each individual piece of the calculation shown in Table 3.

Table 3			
Summary Calculation of Tobacco Settlement Revenue			
Description	FY 2005	FY 2006	FY 2007
Base Payment	\$ 8,000,000,000	\$ 8,000,000,000	\$ 8,000,000,000
Plus:			
Inflation Adjustment	\$ 1,588,292,000	\$ 1,875,940,800	\$ 2,172,219,200
Net Volume Adjustment	\$ (2,873,056,313)	\$ (3,240,761,743)	\$ (3,615,795,307)
Previously Settled States Reduction	\$ (836,046,843)	\$ (826,079,793)	\$ (816,274,775)
Adjusted Base Payment	\$ 5,879,188,844	\$ 5,809,099,264	\$ 5,740,149,118
Less (NPM) Maximum Adjustment 18.6%	\$ -	\$ (1,080,492,463)	\$ (1,067,667,736)
OPMs Payments	\$ 5,879,188,844	\$ 4,728,606,801	\$ 4,672,481,382
Multiplied by MT Share	0.004247591	0.004247591	0.004247591
MT Payment from OPMs	\$ 24,972,390	\$ 20,085,188	\$ 19,846,790
MT Payment from OPMs	\$ 24,972,390	\$ 20,085,188	\$ 19,846,790
Plus MT Payment from SPMs	\$ 1,421,391	\$ 1,397,426	\$ 1,362,356
Plus Additional 'New' SPM Prior Obligation	\$ 41,588	\$ 48,172	\$ 54,411
Total MT Payment	\$ 26,435,368	\$ 21,530,786	\$ 21,263,556

Tobacco Settlement Payment Calculations

Step 1: Calculate Volume Adjustments

To determine what volume adjustment is needed, a comparison must be made of the Master Settlement Agreement base volume to the actual volume of cigarettes sold. The base level of cigarette sales volume in the Master Settlement Agreement is 475,656,000,000 for Original Participating Manufacturers (OPM). The current forecast assumes that the actual volume of cigarettes sold, and used in the calculations for FY 2005 through FY 2007 will be less than the base volume.

Shipments have declined for OPMs due both to a decrease in overall cigarette consumption, and to a loss in market share to other manufacturers. (Cigarette consumption has decreased between 1.0% and 2.0% in the past few years, and is expected to remain within the upper bounds of that range in the future)

Table 4 shows actual and projected OPM cigarette shipments, and volume reductions. OPM cigarette shipment projections for FY 2005 through FY 2007 are based on the average annual change from FY 2000 to FY 2004 of -4.19%. This annual growth rate of -4.19% is used to forecast FY 2005 through FY 2007 shipments. As illustrated on the bottom of Table 4, OPM cigarette shipment are estimated to be 330.221 billion in FY 2005, 316.385 billion in FY 2006, and 303.130 billion in FY 2007.

Table 4			
Cigarette Shipments and Volume Reduction			
Fiscal Year	Shipments (Billions)	Annual % Change	% Change from Base Year
A 1998	475.656	-	-
A 1999	437.000	-8.13%	-8.13%
A 2000	409.019	-6.40%	-14.01%
A 2001	402.662	-1.55%	-15.35%
A 2002	384.228	-4.58%	-19.22%
A 2003	365.247	-4.94%	-23.21%
A 2004	344.661	-5.64%	-27.54%
FY 2000 - FY 2004 Annual Average Change			-4.19%
F 2005	330.221	-4.19%	-30.58%
F 2006	316.385	-4.19%	-33.48%
F 2007	303.130	-4.19%	-36.27%

To make the volume adjustment, the base payments from Original Participating Manufacturers specified in the Master Settlement Agreement are adjusted as follows:

- Payments are adjusted for inflation;
- All payments are adjusted by the 98% multiplier set forth in the agreement; and
- All payments are adjusted for a volume reduction multiplier, which is the percent change in cigarette shipments from the base year. The volume reduction multiplier was approximately 27.54% in FY 2004. As Table 5 shows, the volume reduction multiplier is estimated to be 30.58% in FY 2005, 33.48% in FY 2006, and 36.27% in FY 2007.

Table 5			
Calculation of Volume Adjustment Part 1			
Adjustment	FY 2005	FY 2006	FY 2007
CY Base Payment	\$ 8,000,000,000	\$ 8,000,000,000	\$ 8,000,000,000
Multiplied by Inflation Rate	0.1985365	0.2344926	0.2715274
Inflation Adjustment	\$ 1,588,291,877	\$ 1,875,940,633	\$ 2,172,218,852
Plus CY Base Payment	\$ 8,000,000,000	\$ 8,000,000,000	\$ 8,000,000,000
CY Base Payment Adjusted for Inflation	\$ 9,588,291,877	\$ 9,875,940,633	\$ 10,172,218,852
Multiplied by Multiplier	0.98	0.98	0.98
CY Base Payment Adj. for Inflation & Multiplier	\$ 9,396,526,039	\$ 9,678,421,820	\$ 9,968,774,475
Multiplied by Volume Reduction	0.30575729	0.33484403	0.36271212
Volume Adjustment Part 1	\$ 2,873,056,313	\$ 3,240,761,743	\$ 3,615,795,307

Step 2: Calculate Previously Settled States Reductions

The base payment adjusted for a 3% annual compounded rate of inflation yields a base payment adjusted for inflation. This base payment adjusted for inflation is then adjusted by the Volume Adjustment Part 1. Then the adjusted base payment is multiplied by the previously settled states reduction multiplier of 12.45%, as specified in the Master Settlement Agreement. This gives the previously settled states reduction amount of \$836 million in FY 2005, \$826 million in FY 2006, and \$816 million in FY 2007.

Table 6 shows the previously settled states reduction calculation for FY 2005 through FY 2007.

Table 6			
Calculation of Previously Settled States Reduction			
Payment	FY 2005	FY 2006	FY 2007
Base Payment	\$ 8,000,000,000	\$ 8,000,000,000	\$ 8,000,000,000
Multiplied by Inflation Rate	0.1985365	0.2344926	0.2715274
Inflation Adjustment	\$ 1,588,292,000	\$ 1,875,940,800	\$ 2,172,219,200
Plus Base Payment	\$ 8,000,000,000	\$ 8,000,000,000	\$ 8,000,000,000
Base Payment Adjusted for Inflation	\$ 9,588,292,000	\$ 9,875,940,800	\$ 10,172,219,200
Volume Adjustment Part 1	\$ (2,873,056,313)	\$ (3,240,761,743)	\$ (3,615,795,307)
Plus Volume Adjustment Part 2	\$ -	\$ -	\$ -
Net Volume Adjustment	\$ (2,873,056,313)	\$ (3,240,761,743)	\$ (3,615,795,307)
Plus Base Payment Adjusted for Inflation	\$ 9,588,292,000	\$ 9,875,940,800	\$ 10,172,219,200
Base Payment Adjusted for Inflation & Volume	\$ 6,715,235,687	\$ 6,635,179,057	\$ 6,556,423,893
Multiplied by Previously Settled States Reduction	0.1245	0.1245	0.1245
Previously Settled States Reduction	\$ 836,046,843	\$ 826,079,793	\$ 816,274,775

Step 3: Non-Participating Manufactures (NPM) Adjustment

In addition to the adjustment for decreased volume of sales, if participating manufacturers lose market share to NPMs, they may be entitled to pay less in Master Settlement Agreement (MSA) payments. The NPM adjustment is conditional upon two factors: (1) if there has been a loss in market share for participating manufacturers to NPMs; and (2) was the loss attributable to disadvantages as a result of the tobacco settlement.

There is an additional provision in the tobacco settlement referred to as the 'safe harbor provision'. Under the 'safe harbor provision', a state can avoid a payment reduction due to the NPM adjustment if a qualifying statute is enacted and "diligently enforced". The qualifying statute provides for an amount to be paid into an escrow account for each cigarette sold by NPMs in the state, such that it is equivalent to the amount that would have been paid had the NPM participated in the settlement.

Currently, all states including Montana have enacted qualifying statutes under the 'safe harbor provision'. Because every state enacted these statutes, NPM adjustments were set to zero in the past. However, with the increasing market loss to NPMs, the meaning of "diligent enforcement" is now in question. "Diligent enforcement" was not defined in the Master Settlement Agreement, or in prior case law. There is some uncertainty as to how, or who will determine the meaning of "diligent enforcement". States say the decision should be made in state court, the tobacco companies say the decision should be made in arbitration before a three judge panel of retired federal judges. "Diligent enforcement" would likely include some combination of legislation and enforcement actions.

An independent auditor has already determined that in 2003 there was a loss in market share for participating manufacturers to NPMs. An economics firm will now determine whether the loss was attributable to disadvantages as a result of the tobacco settlement. Tobacco companies can pay a portion of their tobacco settlement payments into a dispute account if they believe the calculation is in error, or the Master Settlement Agreement has been misinterpreted. The disputed amounts will not be distributed to the states until the dispute has been resolved.

The state Attorney General (AGs) office expects both OPMs and SPMs to pay the NPM adjustment amounts into dispute accounts in the future. According to the Attorney General's office, OPMs have agreed not to withhold the NPM adjustment from their FY 2005 payments. However, beginning with the April 15, 2006 payment, the AGs office expects OPMs to withhold the NPM adjustment from their 2006 tobacco settlement payment and all succeeding payments. The AGs office believes that SPMs will start withholding the NPM adjustment from their April 2005 payment.

There are numerous possible outcomes to the dispute over the NPM adjustment. The following is a short list of possible outcomes over the dispute.

1. It is found that the loss in market share for participating manufacturers was not due to disadvantages as a result of the Tobacco Settlement. It is expected that this opinion will be rendered prior to the April 2006 payments. In this case, given the prior assumptions of when OPMs and SPMs will withhold payments, OPM payments would not be affected, and SPM payments held in FY 2005 would be distributed in FY 2006. Montana's estimated revenue would be \$26.4 million in FY 2005, \$26.7 million in FY2006, and \$26.1 million in FY 2007.
2. A settlement is reached between the states and the participating manufacturers in regards to the NPM adjustment. Under this scenario, payments could be reduced by some amount, the 'safe harbor' statute could be revised, or some combination of the two. Depending on the terms of such an agreement and when it is reached, NPM adjustments may not be withheld at all, or NPM adjustment amounts could be withheld indefinitely. The fiscal impacts of such a settlement are unknown because it is uncertain what would be included in a settlement if an agreement were reached.

3. Litigation over the NPM adjustment carries past 2006 and 2007, or it is found that the loss in market share is due to disadvantages as a result of the tobacco settlement and that every state did not “diligently enforce” their ‘safe harbor’ statutes. In either case, the NPM adjustment amounts would be withheld from payment from every state proportionately. Under this scenario Montana's estimated revenue would be \$26.4 million in FY 2005, \$21.5 million in FY 2006, and \$21.3 million in FY 2007. A decrease in estimated revenue from number 1 above of \$5.2 million in FY 2005, and \$4.8 million in FY 2007.

To reiterate, many possible outcomes exist and it is unknown at this time which scenarios are more likely. However, for purposes of this estimate, it is assumed that the dispute over the NPM adjustment will not be resolved prior to the FY 2007 payment, and that the participating manufacturers will withhold the maximum NPM adjustment amounts in FY 2006 and FY 2007.

The NPM adjustment is 3% of the base payment for every 1% of lost market share for the first 16 2/3% of lost market share, and a lower percentage for each additional percentage point thereafter. The adjustment is applied to following year payments made by participating manufacturers.

Participating manufacturers saw a decline in market share of approximately 6.2% in 2003, which calculates to be a maximum NPM adjustment of 18.6% (6.2% x 3). For purposes of this analysis, it is assumed that the maximum adjustment will remain at 18.6% for payments made in FY 2006 and FY 2007. As Table 3 illustrates (tinted grey), an adjustment of 18.6% on OPMs base payment is an estimated reduction of \$1,080,492,463 in FY 2006, and \$1,067,667,736 in FY 2007. Highlighted in Table 7 on the next page, an adjustment of 18.6% on SPMs base payment is an estimated reduction of \$76,464,396 in FY 2005, \$75,175,148 in FY 2006, and \$73,288,609 in FY 2007.

Step 4: Calculate Subsequent Participating Manufacturers' Payment (SPM)

The Subsequent Participating Manufacturers' Payment is equal to the Original Participating Manufacturers' base payment adjusted for “Volume Adjustment Part 1” multiplied by: (1) the ratio of Subsequent Participating Manufacturers' excess market share (EMS) to the Original Participating Manufacturers' excess market share; (2) the inflation rate; (3) the Non-Participating Manufacturers' (NPM) Adjustment, and (4) Montana's share of the payment as set forth in the Master Settlement Agreement.

The ratio of Subsequent Participating Manufacturers' excess market share (EMS) to the Original Participating Manufacturers' excess market share from FY 2003 to FY 2004 increased by 0.19%. Changes in excess market share (EMS) for FY 2005, FY 2006, and FY 2007 are estimated to equal this 0.19% change each year.

Table 7 shows the Subsequent Participating Manufacturers' payment calculation for FY 2005 through FY 2007. The Subsequent Participating Manufacturer's payment is estimated to be \$1.42 million in FY 2005, \$1.40 million in FY 2006, and \$1.36 million in FY 2007.

Table 7 Calculation of SPMs Payment			
Payment	FY 2005	FY 2006	FY 2007
OPM Base Payment	\$ 8,000,000,000	\$ 8,000,000,000	\$ 8,000,000,000
Plus Volume Adjustment Part 1	\$ (2,873,056,313)	\$ (3,240,761,743)	\$ (3,615,795,307)
OPM Base Payment Adjusted for Volume	\$ 5,126,943,687	\$ 4,759,238,257	\$ 4,384,204,693
Multiplied by Ratio of SPM EMS to OPM EMS	0.0669016	0.0687916	0.0706817
SPM Base Payment	\$ 343,000,769	\$ 327,395,832	\$ 309,882,975
Multiplied by Inflation Adjustment	1.1985365	1.2344926	1.2715274
SPM Base Payment Adjusted for Inflation	\$ 411,098,941	\$ 404,167,732	\$ 394,024,693
Less Maximum (NPM) Adjustment - 18.6%	\$ (76,464,403)	\$ (75,175,198)	\$ (73,288,593)
Total SPM Payments	\$ 334,634,538	\$ 328,992,534	\$ 320,736,100
Multiplied by Montana Share	0.004247591	0.004247591	0.004247591
Montana's SPM Payment	\$ 1,421,391	\$ 1,397,426	\$ 1,362,356

Additional SPM Payment

The largest NPM, General Tobacco, signed the tobacco settlement agreement in August 2004 and became a SPM beginning in FY 2005. Along with making normal payments within the framework of the tobacco settlement agreement, General Tobacco will also make payments on a separate ten-year schedule for prior obligations. The prior obligation payments are based on the amount they would have paid under the tobacco settlement agreement, had they participated since the agreements inception in 1998. Shown near the bottom of Table 3, these additional payments are estimated at \$41,588 in FY 2005, \$48,172 in FY 2006, and \$54,411 in FY 2007.

RETAIL TELECOMMUNICATIONS EXCISE TAX

Revenue Description

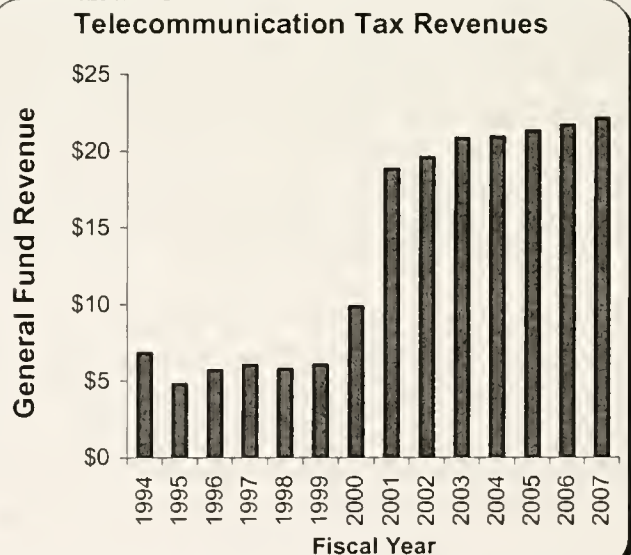
Montana imposes a 3.75% excise tax on retail telecommunications services, which are defined as two-way transmission of information over a telecommunications network that originates or terminates in the state, *and* is billed to a customer with a Montana service address. Telecommunications service providers are required to collect the tax and make quarterly payments within 60 days after the end of each quarter. All revenue is allocated to the general fund.

Historical and Projected Revenue

The telecommunications excise tax replaced the telephone company license tax January 1, 2000.

Table 1
Telecommunications Excise Tax and Telephone
Company License Tax - General Fund Revenues
(\$ millions)

	<u>Fiscal Year</u>	<u>General Fund</u>	<u>Percent Change</u>
A	1994	\$6.835	76.82%
A	1995	\$4.801	-29.76%
A	1996	\$5.712	18.98%
A	1997	\$6.045	5.83%
A	1998	\$5.773	-4.50%
A	1999	\$6.037	4.56%
A	2000	\$9.857	63.28%
A	2001	\$18.838	91.12%
A	2002	\$19.594	4.01%
A	2003	\$20.838	6.35%
A	2004	\$20.919	0.39%
F	2005	\$21.314	1.89%
F	2006	\$21.717	1.89%
F	2007	\$22.127	1.89%



It also was intended to replace revenue losses from lower property taxes on telephone company property. Table 1 shows telephone company license tax receipts for FY 1994 through FY 1999; revenue from the two taxes for FY 2000,

when the telephone company license tax was in effect for the first six months and the telecommunications excise tax was in effect for the last six months; telecommunications excise tax receipts for FY 2001 through FY 2004; and forecasts of telecommunications excise tax receipts for FY 2005 through FY 2007.

The large increases in FY 2000 and FY 2001 reflect the transition from the telephone company license tax to the retail telecommunications excise tax. Revenue is projected to grow slowly in the forecast period.

Forecast Methodology and Projection Calculation

Growth of telecommunications excise tax revenue is forecast based on national projections of the growth of telecommunications expenditures per person and per dollar of personal income and projections of the growth of population and personal income in Montana.

Table 2 shows average annual growth rates for U.S. telecommunications expenditures, U.S. population age 16 and over, and U.S. personal income. The first row shows average growth rates for FY 1991 through FY 2000. In this period, telecommunications expenditures grew much faster than population or personal income. Telecommunications rates were stable and the expenditure growth was primarily due to rapid growth of usage.

Table 2 Growth of US Telecommunications Expenditures Compared to Growth of Population and Personal Income			
-----Average Annual Growth Rate-----			
Fiscal Years	US Telecommunications Expenditures	US Population 16 and Over	US Personal Income
1991 - 2000	7.48%	1.25%	5.54%
2001 - 2004	0.48%	0.34%	3.76%
2005 - 2007	2.44%	1.13%	5.58%

The second row shows average growth rates for FY 2001 through FY 2004. In this period, telecommunications expenditures grew much slower than personal income and only slightly faster than population. The growth of usage slowed and rates fell, especially for long distance. Companies had added long distance capacity hoping to take advantage of opportunities resulting from deregulation, and the industry ended up with significant excess capacity. In addition, many consumers switched to billing plans with a flat monthly fee rather than charges per call or per minute.

Montana telecommunications tax collections have followed the same general pattern. Collections of the telephone company license tax grew by an average of 5.4% per year from FY 1991 through FY 1999, which was the last full fiscal year it was in effect. Growth of the telecommunications excise tax was affected by a credit that was available through FY 2002. Adjusted for this credit, the tax grew by an average of 2.8% per year from FY 2001, the first full fiscal year it was in effect, through FY 2004.

While telecommunications in Montana follows long-term national trends, Montana's year-to-year variations from the trend do not appear to be related to year-to-year variations at the national level. Year-to-year variations in telecommunications tax collections growth are not correlated to variations in national expenditure growth.

The bottom row of Table 2 shows Global Insight's forecasts of growth for FY 2005 through FY 2007. Global Insight predicts that telecommunications usage will begin growing rapidly again but that prices will continue to fall. The result is that telecommunications expenditures are forecast to grow about twice as fast as population but less than half as fast as personal income. This is faster than over the last three years, but much slower than in the 1990s.

The left-hand column of Table 3 shows forecast growth of U.S. telecommunications expenditures per person calculated from the bottom row of Table 2.¹ The middle column shows Global Insight's forecast of the growth of population age 15 and over in Montana. The right-hand column shows the forecast growth rate of telecommunications spending in Montana assuming that the growth rate of spending per person is the same as the national growth rate.²

Table 3 Population and Telecommunications Spending Forecast Average Annual Growth Rates FY 2004 - FY 2007		
US Telecom Spending per Person Over 15	MT Population 15 and Over	Montana Telecom Spending Population-Based Forecast
1.30%	0.63%	1.94%

¹ The growth rate of expenditures per person is $(1 + \text{expenditure growth rate}) / (1 + \text{population growth rate}) - 1$. The growth rate of expenditures as a percent of income is calculated in the same way.

² The spending growth rate is $(1 + \text{spending per person growth rate}) \times (1 + \text{population growth rate}) - 1$.

The left-hand column of Table 4 shows forecast growth of U.S. telecommunications spending as a percent of personal income calculated from the bottom row of Table 2. The middle column shows Global Insight's forecast of the growth of personal income in Montana. The right-hand column shows the forecast growth rate of telecommunications spending in Montana assuming that the growth rate of spending as a percent of personal income is the same as the national growth rate.

Table 4 Income and Telecommunications Spending Forecast Average Annual Growth Rates FY 2004 - FY 2007		
US Percent of Personal Income Spent on Telecom	MT Personal Income	Telecommunications Excise Tax Revenue Income-Based Forecast
-2.97%	4.96%	1.84%

The forecast growth rates shown in Tables 3 and 4 differ by only 0.1%. They are lower than the national growth rate in Table 2 because Global Insight projects both population and income growth to be slower in Montana than nationally through 2007.

This forecast assumes that telecommunications spending and telecommunications excise tax revenue will grow at 1.89%, which is the average of the growth rates in Tables 3 and 4. Revenue is projected to grow at the same rate each year because short-term fluctuations in collections growth are not correlated with national fluctuations in expenditure growth.

Table 5 shows actual FY 2004 collections and forecast collections through FY 2007 with annual growth of 1.89%.

Table 5 Telecommunications Excise Tax Revenue (\$ million)		
Fiscal Year	Annual Growth Rate	Revenue
A 2004		\$20.919
F 2005	1.89%	\$21.314
F 2006	1.89%	\$21.717
F 2007	1.89%	\$22.127

Forecast Risks

The telecommunications industry has seen a number of significant technological and regulatory changes in recent years, and changes of similar magnitude are likely in the near future. Global Insight's forecast of telecommunications expenditure assumes that new technologies and structural changes in telecommunications

markets will continue to drive prices down. If this does not happen, revenue may grow faster than projected.

The major downside risk for the telecommunications excise tax comes from a potential combination of new technology and federal legislation. Congress has twice passed legislation temporarily exempting Internet access charges from state telecommunications taxes. This legislation has expired, but is expected to be renewed and may be made permanent. Montana does not tax separately billed Internet access charges, but does tax charges for bundled services that include both telecommunications and Internet access. Montana also taxes traditional voice communications that are transmitted over the Internet. This technology currently carries a small percentage of calls, but may carry a majority of long distance calls in the future. Some of the Internet tax exemption options that Congress has considered would expand the exemption to preclude states from taxing bundled services that include Internet access or telephone service that uses the Internet, which would reduce telecommunications excise tax revenue.

INSTITUTIONAL REIMBURSEMENTS

Revenue Description

The Montana Department of Public Health and Human Services (DPHHS) operates facilities to treat persons with developmental disabilities and mental illnesses. The Montana Developmental Center in Boulder (MDC) serves persons with developmental disabilities. The Montana State Hospital in Warm Springs (MSH) and the Montana Mental Health Nursing Care Center in Lewistown (MMHNCC) treat persons with severe mental illnesses.

The department charges patients for treatment based on cost and on their ability to pay (53-1-405, MCA). Patients and their families, patients' insurance, Medicare, and Medicaid pay these charges. At MDC and MSH, payments go first to repay the institutions' mortgages (90-7-220 and -221, MCA). After the mortgage obligations are met, payments for care at the four institutions are deposited in the general fund.

Historical and Projected Revenue

Table 1 shows actual institutional reimbursements going to the general fund for FY 1994 through FY 2004, and projections for FY 2005 through FY 2007.

Table 1 Institutional Reimbursements - General Fund Revenues (\$ millions)			
Fiscal Year	General Fund	Percent Change	
A 1994	\$ 15.415	6.41%	
A 1995	\$ 16.456	6.75%	
A 1996	\$ 16.142	-1.91%	
A 1997	\$ 11.158	-30.88%	
A 1998	\$ 10.335	-7.38%	
A 1999	\$ 11.136	7.75%	
A 2000	\$ 11.345	1.88%	
A 2001	\$ 13.554	19.47%	
A 2002	\$ 14.283	5.38%	
A 2003	\$ 13.043	-8.68%	
A 2004	\$ 18.110	38.86%	
F 2005	\$ 16.314	-9.92%	
F 2006	\$ 15.123	-7.30%	
F 2007	\$ 15.134	0.07%	

The pattern of reimbursements through FY 2004 reflects significant changes in the institutions and in the way their costs are paid. First, a mental health managed care system was implemented in FY 1997 for MSH and MMHNCC. The managed care contractor billed patients' families, insurance companies, Medicare, and Medicaid, and then deposited the funds in a special revenue account for the two institutions. This caused the large drop in institutional reimbursements to the general fund in FY 1997. The managed care contract was terminated in FY 2000, but the flow of funds remained the same.

Second, new facilities have been built at MDC and MSH. Mortgage payments for these new facilities began in 1995 for MDC, and in 1997 for MSH.

Third, MSH became Medicare-certified. This allows it to bill Medicare for more of eligible residents' expenses than it has in the past. While only about 5% of patient days are eligible for Medicare reimbursement, this significantly increased total reimbursements to MSH, beginning late in FY 2001.

Fourth, the average populations have changed at some of the institutions. DPHHS moved some residents from one institution to another and moved some residents back into their communities in assisted-living programs or other arrangements. At the same time, court-ordered admissions have increased.

Fifth, legislation passed by the 2003 legislature significantly affected reimbursements. HB 722 and HB 743 make state institutions subject to state health care facility taxes. These taxes are part of the cost basis for Medicaid reimbursement, which increased reimbursements. HB 727 closed Eastmont at the end of December 2003. This reduced reimbursements beginning in FY 2004. Through FY 2003, Medicaid payments for MSH and MMHNCC were deposited in a special revenue account. HB 121 requires that they be deposited in the general fund.

Future reimbursements will be affected by the settlement of a lawsuit against DPHHS. As part of this settlement, DPHHS has agreed to move some of the residents of MDC to assisted-living facilities in their communities. These facilities are not state institutions, and the state will not receive reimbursement for services at them.

Beginning in FY 2005, state district courts will begin reimbursing DPHHS for costs of housing defendants who have been found incompetent to stand trial.

Forecast Methodology and Projection Calculation

At each institution, there are up to five sources of reimbursement for patients' costs: patients and their families; insurance; Medicare; Medicaid; and the state court system. There are four steps to estimating general fund receipts: 1) estimating daily reimbursement rates for each type of reimbursement at each institution; 2) estimating the number of care days for which each institution will be reimbursed; 3)

multiplying the reimbursement rates by the number of care days to give gross reimbursements; and 4) subtracting the institutions' mortgage payments to give general fund revenue.

STEP 1 : Average Daily Reimbursements

There are four primary reimbursement sources. They are patients and their families, insurance, Medicare, and Medicaid. Residents and their families are billed by DPHHS based on cost and their ability to pay. For adults in long-term care, the primary resource for these payments is Supplemental Security Income disability payments. The Social Security Administration adjusts these payments for inflation annually based on the change in the Bureau of Labor Statistics consumer price index for urban wage earners (CPIW). Daily reimbursement rates were estimated by applying Global Insight's forecast of the CPIW to actual reimbursements in FY 2004.

Table 2 shows reimbursements from patients and their families per day in FY 2004, the forecast of the annual percentage change in the CPIW since FY 2004, and forecast private reimbursement rates for each of the institutions through FY 2007.

Table 2				
Average Patient and Family Reimbursement per Day				
Fiscal Year	CPIW % Change since 2004	MDC	MSH	MMHNCC
A 2004		\$10.23	\$14.28	\$22.84
F 2005	2.49%	\$10.49	\$14.63	\$23.40
F 2006	3.95%	\$10.90	\$14.84	\$23.74
F 2007	5.58%	\$11.51	\$15.07	\$24.11

Private insurance covers a small fraction of the cost of services at state institutions. Individual residents' policies may or may not include cost-of-living adjustments, but over time, the average coverage of new residents should be increasing. Thus, insurance reimbursements are forecast to increase at the rate of inflation.

Table 3 shows the average insurance reimbursement per day for FY 2004 through FY 2007. These rates are insurance reimbursements for a few covered residents divided by the total number of care days for all residents, most of whom have no applicable coverage.

Table 3				
Average Insurance Reimbursement per Day				
Fiscal Year	CPI-W % Change since 2004	MDC	MSH	MMHNCC Secure Care
A 2004		\$0.07	\$5.82	\$0.07
F 2005	2.49%	\$0.08	\$5.97	\$0.08
F 2006	3.95%	\$0.08	\$6.05	\$0.08
F 2007	5.58%	\$0.08	\$6.15	\$0.08

Medicare provides coverage for medical costs for the aged and disabled. Medicare rates are set for each fiscal year by the Health Care Financing Administration using a formula that depends on medical cost inflation, past payments, growth in the number of persons covered, the type of health care service received, and the state and county where it is received. Future Medicare payments per day are estimated by applying Global Insight's forecast of the consumer price index for expenditures on medical care (CPI-M) to the baseline rates.

Table 4 shows Medicare reimbursements per care day in FY 2004, Global Insight's forecast of medical cost inflation, and estimated Medicare reimbursements per care day for FY 2005 through FY 2007.

Table 4 Average Medicare Reimbursement per Day				
Fiscal Year	CPI-M % Change since 2004	MDC	MSH	MMHNCC Secure Care
A 2004		\$0.30	\$23.88	\$0.50
F 2005	2.80%	\$0.31	\$24.47	\$0.52
F 2006	5.99%	\$0.32	\$24.82	\$0.54
F 2007	9.85%	\$0.34	\$25.21	\$0.56

Daily reimbursement rates for Medicaid are set at the beginning of each biennium. The rate for the first year of the biennium is set equal to the difference between the full daily cost of care and expected reimbursements from other sources. For the second year of the biennium, the same formula is used, but rates for the second year are limited to 103.3% of the first year's rates.

Medicaid pays costs that residents cannot. Therefore, Medicaid reimbursements per day equal the full cost rate less the patient and family reimbursements per day shown in Table 2.

Medicaid is a joint federal-state program, and only the federal portion comes to the state as a net reimbursement. The federal government pays a fixed share of the reimbursement for each care day. Medicaid also pays some ancillary costs that are not on a daily basis, such as medications. The total for these payments was divided by care days to give an average daily rate.

Table 5 shows the daily reimbursement rates, the federal share of costs, federal ancillary payments, and the net Medicaid reimbursement rates.

Table 5 Federal Medicaid Reimbursements										
Fiscal Year	Medicaid Full Cost Rate		Patient Payment per Day		Medicaid Daily Rate		Federal Share		Ancillary Payments	Federal Medicaid Daily Rate
-----Montana Developmental Center-----										
F 2005	\$511.79	-	\$10.49	=	\$501.30	x	72.14%	+	\$0.90	= \$362.54
F 2006	\$518.36	-	\$10.90	=	\$507.46	x	70.90%	+	\$0.91	= \$360.67
F 2007	\$517.27	-	\$11.51	=	\$505.76	x	70.16%	+	\$0.93	= \$355.74
-----Montana State Hospital-----										
F 2005	\$200.64	-	\$14.63	=	\$186.01	x	72.14%	+	\$0.00	= \$134.19
F 2006	\$204.65	-	\$14.84	=	\$189.82	x	70.90%	+	\$0.00	= \$134.57
F 2007	\$208.75	-	\$15.07	=	\$193.68	x	70.16%	+	\$0.00	= \$135.87
-----Montana Mental Health Nursing Care Center-----										
F 2005	\$250.73	-	\$23.40	=	\$227.33	x	72.14%	+	\$0.00	= \$163.99
F 2006	\$258.25	-	\$23.74	=	\$234.51		70.90%	+	\$0.00	= \$166.26
F 2007	\$266.00	-	\$24.11	=	\$241.89		70.16%	+	\$0.00	= \$169.70

Step 2: Care Days

Table 6 shows projected populations for FY 2005 through FY 2007. DPHHS plans to reduce the number of residents at MDC during FY 2005 and then have a stable population in FY 2006 and FY 2007. The number of residents at the other institutions is expected to be stable through FY 2007.

Table 6 Forecast Institutional Populations Average Residents			
Fiscal Year	MDC	MSH	MMHNCC
F 2005	89.6	189.1	70.0
F 2006	80.0	189.1	70.0
F 2007	80.0	189.1	70.0

Step 3: Reimbursements

Total reimbursement for a fiscal year at each institution is the average daily reimbursement times the number of care days. Care days are the average number of residents times 365 days in a year (366 in leap years). Tables 7 through 9 show the calculation of reimbursements. They show non-Medicaid and Medicaid reimbursements separately because not all residents are eligible for Medicaid.

Table 7 shows total reimbursements for MDC.

Table 7 Forecast Reimbursements, Montana Developmental Center						
Fiscal Year	-----Non-Medicaid-----			-----Medicaid-----		
	Care Days	Average Daily Reimbursement		Care Days	Average Daily Reimbursement	Total
F 2005	32,721	x \$10.87	+	30,758	x \$362.54	= \$11,506,591
F 2006	29,200	x \$11.30	+	27,448	x \$360.67	= \$10,229,768
F 2007	29,200	x \$11.93	+	27,448	x \$355.74	= \$10,112,798

Table 8 shows total reimbursements for MSH. It includes \$1 million in anticipated reimbursements from the Judicial Branch for defendants who have been found unfit to stand trial. This is a new reimbursement source in FY 2005, and no projections have been made for populations or daily charges. The estimate is based on costs incurred in FY 2004 for housing and treating persons the courts placed in state institutions because they were unfit to stand trial.

Table 8 Forecast Reimbursements, Montana State Hospital						
Fiscal Year	-----Non-Medicaid-----			-----Medicaid-----		
	Care Days	Average Daily Reimbursement		Care Days	Average Daily Reimbursement	Judiciary
F 2005	69,004	x \$45.07	+	2,415	x \$134.19	+ \$1,000,000 = \$4,434,044
F 2006	69,004	x \$45.71	+	2,415	x \$134.57	+ \$1,000,000 = \$4,479,319
F 2007	69,004	x \$46.43	+	2,415	x \$135.87	+ \$1,000,000 = \$4,532,019

Table 9 shows reimbursements for MMHNCC. In addition to reimbursements based on care days, Medicaid also reimburses MMHNCC for medicines dispensed through the institution's pharmacy.

Table 9 Forecast Reimbursements, Montana Mental Health Nursing Care Center							
Fiscal Year	-----Non-Medicaid-----			-----Medicaid-----			Total
	Care Days	Average Daily Reimbursement		Care Days	Average Daily Reimbursement	Pharmacy Reimbursement	
F 2005	25,550	x \$24.00	+	15,585	x \$163.99	+ \$127,000	= \$3,296,025
F 2006	25,550	x \$24.36	+	15,585	x \$166.26	+ \$130,900	= \$3,344,297
F 2007	25,550	x \$24.75	+	15,585	x \$169.70	+ \$135,700	= \$3,412,685

Step 4: General Fund Revenues

General fund revenue is total reimbursements minus debt service payments for MDC and MSH. Table 10 shows the calculation of general fund receipts from institutional reimbursements for service in FY 2005 through FY 2007.

Table 10 Institutional Reimbursements to the General Fund (\$ millions)							
Fiscal Year	-----Reimbursements-----			----Debt Service----			General Fund
	MDC	MSH	MMHNCC	MDC	MSH		
F 2005	\$11.507	+	\$4.434	+	\$3.296	- \$1.013 - \$1.909	= \$16.314
F 2006	\$10.230	+	\$4.479	+	\$3.344	- \$1.017 - \$1.913	= \$15.123
F 2007	\$10.113	+	\$4.532	+	\$3.413	- \$1.015 - \$1.909	= \$15.134

ACCOMMODATIONS TAXES

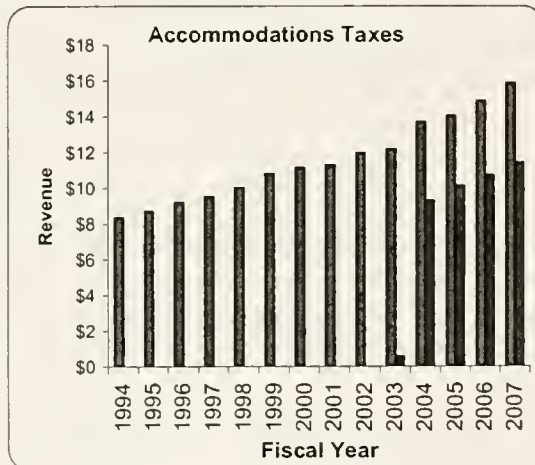
Revenue Description

Montana imposes a 4% lodging facility use tax on accommodations charges of hotels, motels, and campgrounds. Beginning June 1, 2003, Montana imposes an additional 3% sales tax on accommodations charges. Revenue from the accommodations sales tax is deposited in the general fund. Revenue from the lodging facilities use tax is allocated to tourism promotion activities.

Historical and Projected Revenue

Table 1 shows collections of the lodging facility use tax and the accommodations sales tax as recorded on the state accounting system for FY 1994 through FY 2004 and forecasts through FY 2007.

Table 1 Accommodations Taxes (\$ millions)				
<u>Fiscal Year</u>	<u>Lodging Facility Use Tax</u>	<u>Percent Change</u>	<u>Sales Tax</u>	<u>Percent Change</u>
A 1994	\$8.349	3.97%		
A 1995	\$8.685	4.02%		
A 1996	\$9.198	5.91%		
A 1997	\$9.510	3.39%		
A 1998	\$10.008	5.24%		
A 1999	\$10.774	7.65%		
A 2000	\$11.120	3.21%		
A 2001	\$11.287	1.50%		
A 2002	\$11.965	6.01%		
A 2003	\$12.169	1.70%	\$0.571	NA
A 2004	\$13.703	12.60%	\$9.279	NA
F 2005	\$14.046	2.50%	\$10.113	8.99%
F 2006	\$14.882	5.95%	\$10.715	5.95%
F 2007	\$15.859	6.57%	\$11.419	6.57%



From FY 1994 to FY 2004, lodging facility use tax revenue grew at an average annual rate of 5.1% with considerable year-to-year variation. It is forecast to continue to grow at about the same average rate with the year-to-year variations continuing. The new sales tax on accommodations was collected for one month in FY 2003. FY 2004 is the first year with full year collections. The two taxes have the same tax base and are forecast to grow at the same rate.

Forecast Methodology and Projection Calculation

Accommodations tax collections are forecast using a statistical forecasting model. The model predicts the annual growth rate of collections based on the previous year's growth rates of collections and national spending on recreation. These growth rates are applied to actual lodging facility use tax collections for FY 2004 to forecast lodging facility use tax collections for FY 2005 through FY 2007. Sales tax collections are forecast to be a constant percentage of lodging facility use tax collections.

Lodging facility use tax is paid quarterly. Revenue recorded in the state accounting system for a fiscal year equals actual collections for the first three quarters and the Department of Revenue's estimate of collections for the last quarter of the fiscal year. In the last three fiscal years, actual collections for the last quarter have been significantly different from estimated collections. The difference between estimated and actual fourth quarter revenue is shown on the accounting system the next fiscal year as prior year revenue.

Table 2 shows revenue recorded in the state accounting system for FY 2001 through FY 2004, actual collections for FY 2001 through FY 2004, and the growth rate of actual collections.

Table 2			
Lodging Facility Use Tax Collections			
(\$ millions)			
Fiscal Year	Recorded Revenue		Percent Change
	With 4th Quarter Estimated	Actual Collections	
2001	11.287	11.285	1.50%
2002	11.965	12.312	9.09%
2003	12.169	12.562	2.04%
2004	13.703	13.440	6.98%

Statistical models were estimated to measure relationships between actual collections and national measures of economic activity related to tourism and lodging from FY 1994 through FY 2004. The model that fit the data best predicts the growth rate of collections based on the last year's growth rates of collections and national consumer spending on recreation. Historically, when collections and national recreation spending have grown faster in one year, collections have tended to grow slower the next year. The model predicts that this will continue.

Table 3 shows details of the model. The first row shows the average growth rate of collections for FY 1995 through FY 2004. The second and third rows show the average values of the two variables used to predict collections growth each year, the previous year's growth rates for collections and national recreation spending. The model predicts that if collections and national recreation spending grew at their average rates of 4.6% and 7.34% last year, collections will grow by 4.90% this year, which is the same as the average rate for FY 1995 through FY 2004.

Table 3 Lodging Facility Use Tax Forecasting Model		
	Average Growth Rates	Model Coefficient
Collections Growth Rate	4.90%	
Previous Year's Collections Growth Rate	4.60%	-0.6612
Previous Year's US Recreation Spending Growth Rate	7.34%	-1.1486

The coefficients in the right-hand column show the amount by which the predicted growth rate changes when the explanatory variables change. For every percentage point that last year's collections growth rate exceeded 4.60%, the model predicts that this year's collections growth rate will be 0.6612% lower than 4.90%. For every percentage point that last year's growth rate of national recreation spending exceeded 7.34%, the model predicts that this year's collections growth rate will be 1.1486% lower than 5.11%.

In FY 2004, actual collections shown in Table 2 grew by 6.98% and national recreation spending grew by 6.31%. Collections in FY 2005 are forecast to grow by 4.51% ($4.90\% - 0.6612 \times (6.98\% - 4.60\%) - 1.1486 \times (6.31\% - 7.43\%)$). The first row of Table 4 shows actual growth rates for collections and national recreation spending for FY 2004 and the resulting forecast growth rate for tax collections in FY 2005. The second and third rows show the model's forecasts of collections growth for FY 2005 and FY 2006, Global Insight's forecast of national recreation spending growth for FY 2005 and FY 2006, and the resulting tax collections growth rate forecasts for FY 2006 and FY 2007.

Table 4 Forecast Lodging Facility Use Tax Growth Rates			
Fiscal Year	Previous Year's Collections Growth Rate	Previous Year's US Recreation Spending Growth Rate	Accommodations Tax Growth Rate
F 2005	6.98%	6.31%	4.51%
F 2006	4.51%	6.48%	5.95%
F 2007	5.95%	5.11%	6.57%

Table 5 shows actual collections for the lodging facility use tax and the accommodations sales tax for FY 2004 and forecasts for FY 2005 through FY 2007. Lodging facility use tax collections are forecast by applying the growth rates in Table 4 to the actual FY 2004 collections.

Table 5 Forecast Accommodations Tax Collections (\$ millions)			
Fiscal Year	Lodging Facility Use Tax Growth Rate	Lodging Facility Use Tax	Sales Tax
A 2004		13.440	9.279
F 2005	4.51%	14.046	10.113
F 2006	5.95%	14.882	10.715
F 2007	6.57%	15.859	11.419

The lodging facility use tax and the accommodations sales tax are imposed on the same accommodations charges. The lodging facility use tax rate is 4% and the accommodations sales tax rate is 3%. Sales tax collected by accommodations operators should be 75% of lodging facility use tax collections. Accommodations operators may retain a vendor allowance of the lesser of 5% of sales tax collected or \$1,000 per quarter. Larger hotels and motels will be at the \$1,000 limit, and total vendor allowances are projected to be 4% of total collections. As shown in Table 5, sales tax remittances to the state are projected to be 72% (96% of 75%) of lodging facility use tax collections.

All accommodations sales tax revenue is deposited in the general fund.

Lodging facility use tax revenue is distributed as follows:

1. The Department of Revenue retains lodging facility use tax revenue equal to the department's appropriation for administering the tax and makes refunds to state agencies for the tax that they paid on employee's business travel.
2. The Montana Heritage Preservation and Development account receives \$0.400 million.
3. The remainder is allocated
 - a. 1% to the Historical Society for roadside historic sites and signs,
 - b. 2.5% to the university system for tourism research,
 - c. 6.5% to the Department of Fish, Wildlife and Parks for parks maintenance,
 - d. 67.5% to the Department of Commerce for statewide tourism promotion, and
 - e. 22.5% to regional tourism promotion agencies.

Table 6 shows the allocation of lodging facility use tax for FY 2005 through FY 2007.

Table 6 Lodging Facility Use Tax Allocation (\$ millions)									
Fiscal Year	Revenue	DOR Tax Admini- stration	State Agency Reimburse- ment	Mt Heritage Preservation Development Account	Historical Society - Sites & Signs	University System - Travel Research	DFWP - Parks Mainte- nance	Commerce - Travel Promotion	Regional Travel Promotion
F 2005	14.046	0.141	0.117	0.400	0.134	0.335	0.870	9.037	3.012
F 2006	14.882	0.146	0.120	0.400	0.142	0.355	0.924	9.596	3.199
F 2007	15.859	0.150	0.124	0.400	0.152	0.380	0.987	10.250	3.417

HEALTH CARE FACILITY UTILIZATION FEES

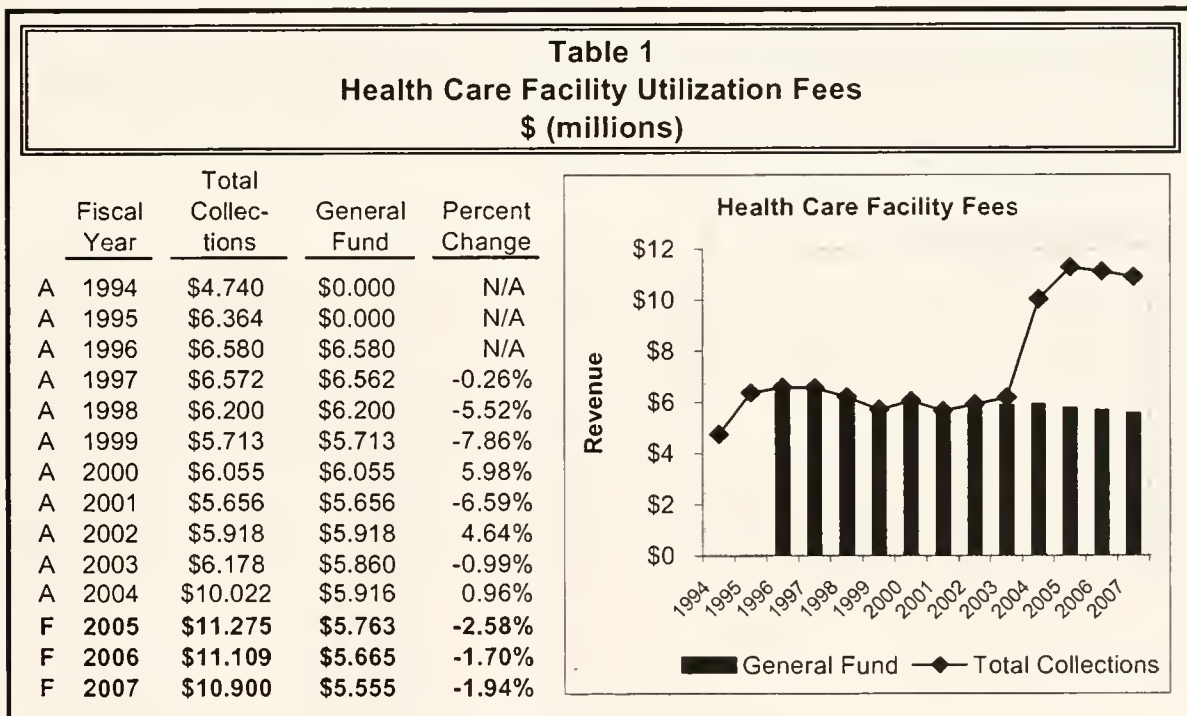
Revenue Description

Montana imposes fees per bed day on nursing facilities and intermediate care facilities for the developmentally disabled. The fee for nursing facilities was \$2.80 per bed day through FY 2002. In FY 2003 the fee was raised to \$4.50, and beginning in FY 2005 it will be \$5.30 (15-60-102, MCA). Through FY 2002, all fees were allocated to the general fund. Beginning in FY 2003, \$2.80 of the fee per day is allocated to the general fund and the remainder is allocated to a state special revenue fund.

The fee for intermediate care facilities for the developmentally disabled is 5% of revenue (15-67-102, MCA). Fees collected from the facilities operated by the Department of Public Health and Human Services are allocated 30% to the general fund and 70% to the prevention and stabilization special revenue fund.

Historical and Projected Revenue

Table 1 shows health care facility fee collections from FY 1994 through FY 2004 and projections for FY 2005 through FY 2007.



Nursing facility fees were enacted in HB 93 of the 1991 legislative session. The fee was \$1 per bed day for FY 1992 and \$2 per bed day for FY 1993 and applied only to

bed days reimbursed by a third-party payer, such as insurance or a public assistance program. All revenue was deposited in the general fund.

HB 333 (1993 session) applied the fee to all bed days beginning in FY 1994. HB 333 also raised the fee to \$2.80 beginning in FY 1995, and allocated all revenue to the nursing facilities fee state special revenue account. SB 83 (1995 session) allocated all revenue to the general fund beginning in FY 1996.

The 2003 legislature passed three bills that changed health care facility fees. HB 705 set the nursing facilities fee at \$4.50 in FY 2004 and \$5.30 beginning in FY 2005 and allocated the additional revenue to the nursing facilities fee account. HB 743 made the Montana Mental Health Nursing Care Center subject to the nursing facility fee and allocated 30% of fees from this facility to the general fund and 70% to a new prevention and stabilization account. HB 722 created a new fee equal to 5% of charges for care that applies only to the Montana Developmental Center. It is allocated 30% to the general fund and 70% to the prevention and stabilization fund.

Forecast Methodology and Projection Calculation

Revenue is estimated separately for fees from private nursing homes, the Montana Mental Health Nursing Care Center (MMHNCC), and the Montana Developmental Center (MDC).

Bed days at private nursing homes and public nursing homes other than MMHNCC and MDC have been decreasing over time as other options have become available for persons who need some assistance but do not require full-time nursing care.

Non-State Facilities

Table 2 shows taxable bed days in FY 1996 through FY 2004 and projected bed days for FY 2005 through FY 2007.

From FY 1996 through FY 2004, taxable bed days declined at an average rate of 2.02%. Bed days are projected to continue to decline at this rate in FY 2005 through FY 2007.

Table 2		
Taxable Bed Days at Non-State Facilities		
<u>Fiscal Year</u>	<u>Taxable Bed Days</u>	<u>Percent Change</u>
A 1996	2,364,601	
A 1997	2,307,955	-2.40%
A 1998	2,242,418	-2.84%
A 1999	2,160,188	-3.67%
A 2000	2,113,805	-2.15%
A 2001	2,083,501	-1.43%
A 2002	2,072,696	-0.52%
A 2003	2,078,448	0.28%
A 2004	2,008,017	-3.39%
F 2005	1,967,405	-2.02%
F 2006	1,927,613	-2.02%
F 2007	1,888,626	-2.02%

Table 3 shows revenue from the bed days projected in Table 2. General fund revenue is calculated by multiplying bed days by the general fund portion of the fee per bed day, \$2.80. Revenue to the nursing facility utilization fee account is calculated by multiplying bed days by the portion of the fee dedicated to this account, \$2.50.

Table 3 Revenue from Non-State Nursing Facilities					
Fiscal Year	Bed Days	General Fund		Nursing Facility Utilization Fee Account	
		Fee per Bed Day	Collections	Fee per Bed Day	Collections
F 2005	1,967,405	\$2.80	\$5,508,733	\$2.50	\$4,918,511
F 2006	1,927,613	\$2.80	\$5,397,317	\$2.50	\$4,819,033
F 2007	1,888,626	\$2.80	\$5,288,154	\$2.50	\$4,721,566

State Facilities

Table 4 shows revenue from the Montana Mental Health Nursing Care Center. Bed days are forecast by the Department of Public Health and Human Services, which operates the facility. Total collections equal the number of bed days multiplied by the fee per bed day. Thirty percent of collections are allocated to the general fund and 70% are allocated to the prevention and stabilization account.

Table 4 Nursing Facility Utilization Fee - MMHNCC						
Fiscal Year	MMHNCC Bed Days		Fee per Bed Day		Total Collections	General Fund (30%)
						Prevention and Stabilization (70%)
F 2005	25,550	x	\$5.30	=	\$135,415	\$40,625
F 2006	25,550	x	\$5.30	=	\$135,415	\$40,625
F 2007	25,550	x	\$5.30	=	\$135,415	\$40,625
						\$94,791
						\$94,791
						\$94,791

The Montana Developmental Center is the only facility subject to the intermediate care facility utilization fee. The fee is 5% of the cost of care billed to residents and third parties.

Table 5 shows revenue from the Montana Developmental Center. The cost of care is estimated by the Department of Public Health and Human Services, which operates the facility, based on planned numbers of residents and expected costs. Thirty percent of collections are allocated to the general fund and 70% are allocated to the prevention and stabilization account.

Table 5 Intermediate Care Facility Utilization fee						
Fiscal Year	MDC Cost of Care		Tax Rate		Total Collections	General Fund (30%) Prevention and Stabilization (70%)
F 2005	\$14,249,301	x	5%	=	\$712,465	\$213,740 \$498,726
F 2006	\$15,136,126	x	5%	=	\$756,806	\$227,042 \$529,764
F 2007	\$15,104,377	x	5%	=	\$755,219	\$226,566 \$528,653

Total Collections

Total collections for each fund are calculated by summing the collections from non-state facilities, shown in Table 3, and collections from the two state facilities, shown in Tables 4 and 5. Table 6 shows total projected collections for each fund and the total for all funds.

Table 6 Total Health Care Facilities Utilization Fee Collections (\$ million)						
Fiscal Year	General Fund		Nursing Facility Utilization Fee Account		Prevention and Stabilization Account	Total Collections
F 2005	5.763	+	4.919	+	0.594	= 11.275
F 2006	5.665	+	4.819	+	0.625	= 11.109
F 2007	5.555	+	4.722	+	0.623	= 10.900

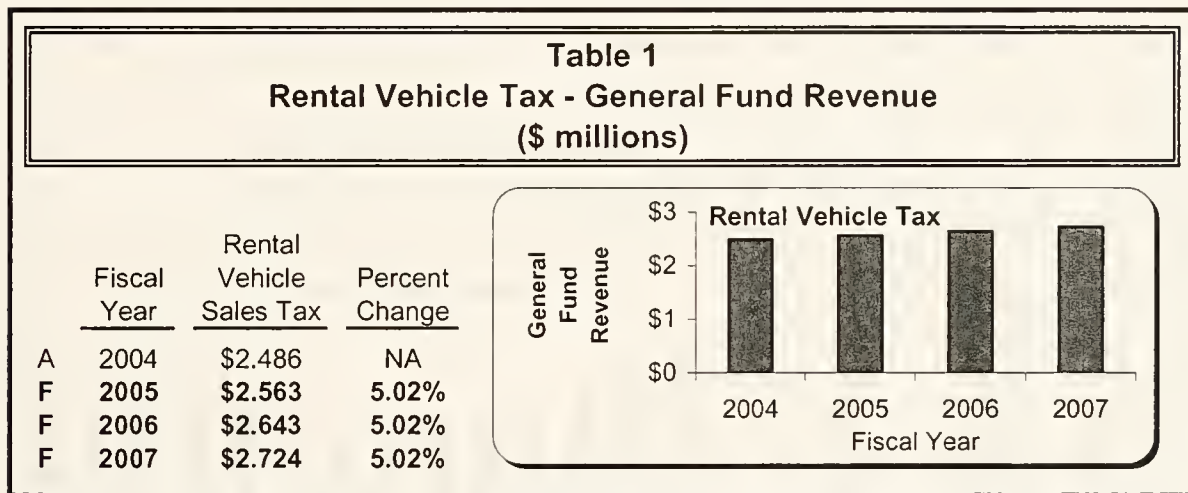
RENTAL CAR SALES TAX

Revenue Description

Beginning July 1, 2003, Montana imposes a 4% tax on the base rental charge for rental vehicles. All revenue is allocated to the general fund.

Historical and Projected Revenue

The rental car sales tax has been collected for only one full year. Table 1 shows actual collections for FY 2004 and forecast collections through FY 2007.



Forecast Methodology and Projection Calculation

The sales tax on rental vehicles has been collected for only one year. Thus, there is no collections history that can be used to estimate the future growth of the tax. At the national level, the Economic Census, which is conducted every five years, reported receipts from motor vehicle rentals of \$26.462 billion in 1997 and \$33.798 billion in 2002. This represents an average annual rate of growth of 5.02%. Montana vehicle rental receipts and tax collections are forecast to grow at this rate through FY 2007.

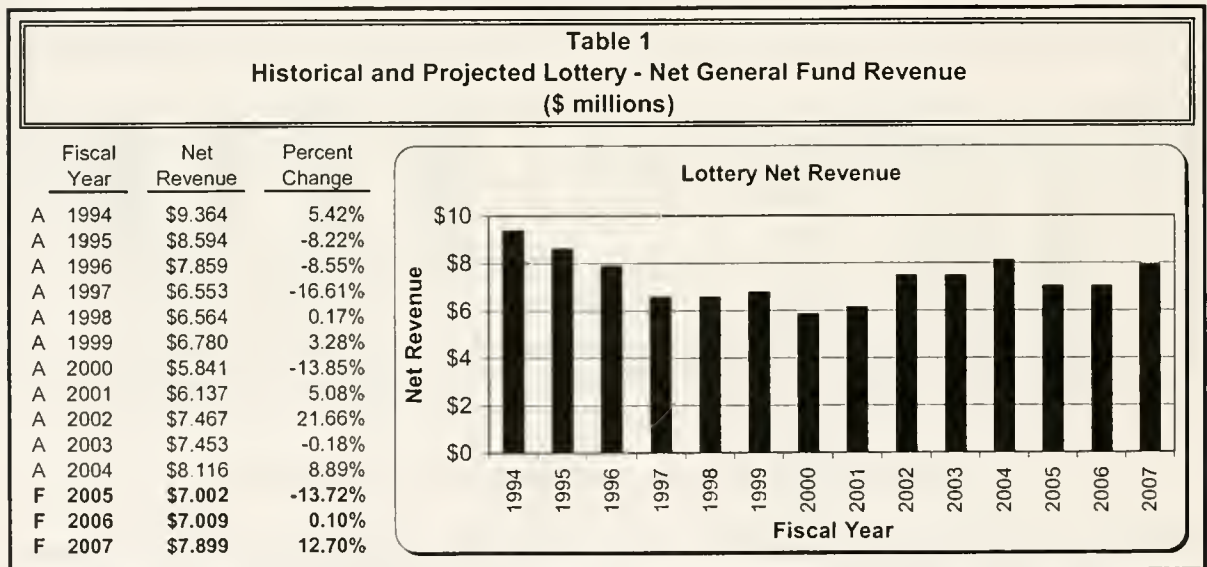
LOTTERY

Revenue Description

Section 23-7-402, MCA, directs the net revenue from the operation of the lottery to be deposited quarterly in the general fund. Net revenue from the lottery includes the sum of ticket sales, short-term investment pool and Multi-State Lottery Association interest and miscellaneous income, less payment of prizes, commissions, and operating expenses.

Historical and Projected Revenue

Table 1 shows historical and projected net general fund revenue from the lottery over the period FY 1994 through FY 2007.



Since 1995 all net revenue is deposited to the general fund. Net revenues from the lottery reached a maximum in FY 1994, and then declined significantly until FY 1998. In fiscal years 2002, 2003, and 2004 net revenue increased to over \$7 million each year. However, included in the net revenue amounts listed in Table 1 are one-time adjustments due to changes in accounting practices and unclaimed prize refunds of \$428,618 in FY 2002, \$333,626 in FY 2003, and \$428,959 in FY 2004. FY 2004 revenues also increased due to an unusually high powerball jackpot of over \$200 million that improved ticket sales.

General fund revenue is projected to decrease by 13.72% in FY 2005, then increase by 0.10% in FY 2006, and 12.70% in FY 2007. The decrease from FY 2004 to FY 2005 is due to the large powerball jackpot in the first quarter of FY 2004 increasing

revenues, along with the aforementioned \$428,959 one-time upwards adjustment in FY 2004 due to a rebalancing of prize reserve funds from the Multi-State Lottery Association (MUSL). The anticipated increase of 12.70% in FY 2007 is attributed to the current lottery gaming system being completely depreciated and amortized in March 2006. The cost to continue using the current system is significantly less than the amortization and depreciation expenses through FY 2006.

Forecast Methodology and Projected Calculation

Forecasts of general fund revenue from the lottery are calculated by projecting gross revenues from ticket sales, short-term investment pool and Multi-State Lottery Association interest and miscellaneous income, and subtracting projected prizes, commissions, and operating expenses.

Step 1: Calculate Gross Revenues

Table 2 shows gross receipts (all interest income, miscellaneous income, and ticket sales), adult population, and per capita receipts for FY 1994 through FY 2007. Interest and miscellaneous income make up a minimal portion of total revenue, 0.2% in FY 2004. Since it is such a small proportion of total revenue, it is aggregated into gross receipts for estimation purposes.

Adult per capita receipts reached a maximum in FY 1994 at \$55.51 per person, and then declined through FY 1997, where per capita receipts hit its historic low point at \$40.65. Per capita receipts were stable over the period FY 1998 through FY 2001, and then began increasing in FY 2002 due to large jackpots, new games, and new terminals. The estimate of per capita receipts for FY 2005 through FY 2007 is the average per capita receipts over FY 2001 through 2004 of \$45.70.

Table 2 Per Capita Lottery Receipts (\$ millions) FY 1994 through FY 2005			
Fiscal Year	Gross Receipts	MT Adult* Population	Per Capita Receipts
A 1994	\$37.607	677,511	\$55.51
A 1995	\$32.965	689,259	\$47.83
A 1996	\$32.021	696,457	\$45.98
A 1997	\$28.512	701,376	\$40.65
A 1998	\$30.119	707,240	\$42.59
A 1999	\$30.386	714,269	\$42.54
A 2000	\$30.261	724,323	\$41.78
A 2001	\$30.699	733,465	\$41.85
A 2002	\$33.817	741,490	\$45.61
A 2003	\$34.774	747,936	\$46.49
A 2004	\$36.784	753,037	\$48.85
Average (FY 2001 through FY 2004):			\$45.70
F 2005	\$34.626	757,695	\$45.70
F 2006	\$34.820	761,921	\$45.70
F 2007	\$35.004	765,965	\$45.70

*Source: Global Insight, Inc. Forecast of MT Population Age 15 and Over.

Forecast gross receipts are calculated as the product of estimated Montana adult population multiplied by estimated per capita receipts. Gross receipts are estimated to be \$34.626 million in FY 2005, \$34.820 million in FY 2006, and \$35.004 million in FY 2007.

Step 2: Calculate Prizes and Commissions

Table 3 shows historic gross receipts, prizes and commissions, and prizes and commissions as a percent of gross receipts. The share of gross receipts represented by prizes and commissions has remained constant over time. Shown on the lower portion of Table 3, prizes and commissions as a percent of total receipts is anticipated to remain fixed at the average level since FY 2001 of 57.21%.

Prizes and commissions are estimated to be \$19.810 million in FY 2005, \$19.920 million in FY 2006, and \$20.026 million in FY 2007.

Table 3 Prizes and Commissions as a Percent of Receipts (\$ millions) FY 1994 through FY 2007			
Fiscal Year	Gross Receipts	Prizes & Commissions*	Prizes & Commissions % of Total Receipts
A 1994	\$37.607	\$20.217	53.76%
A 1995	\$32.965	\$17.955	54.47%
A 1996	\$32.021	\$17.680	55.21%
A 1997	\$28.512	\$15.878	55.69%
A 1998	\$30.119	\$16.971	56.35%
A 1999	\$30.386	\$16.735	55.08%
A 2000	\$30.261	\$17.321	57.24%
A 2001	\$30.699	\$17.462	56.88%
A 2002	\$33.817	\$19.277	57.00%
A 2003	\$34.774	\$19.932	57.32%
A 2004	\$36.784	\$21.200	57.63%
Average (FY 2001 through FY 2004):			57.21%
F 2005	\$34.626	\$19.810	57.21%
F 2006	\$34.820	\$19.920	57.21%
F 2007	\$35.004	\$20.026	57.21%

*FY 2002 has an addition of \$190,935 due to a one-time unclaimed prize refund.
*FY 2003 has an addition of \$333,626 due to a one-time unclaimed prize refund.
*FY 2004 has an addition of \$428,959 from a one-time refund of prize reserves from MUSL.

Step 3: Calculate Operating Expenses

Total operating expenses are comprised of two components: (1) other operating expenses, and (2) depreciation and amortization.

Table 4 on the following page, shows total operating expenses, depreciation and amortization expenses, other operating expenses, gross receipts, and other operating expenses as a percent of gross receipts for FY 1994 through FY 2004.

Table 4
Other Operating Expenses as a Percent of Receipts (\$ millions)
FY 1994 through FY 2004

Fiscal Year	Total Operating Expenses	-	Depreciation and Amortization	=	Other Operating Expenses	Gross Receipts	Other Oper. Exp. % of Gross Rec.
1994	\$8.027	-	\$0.042	=	\$7.984	\$37.607	21.23%
1995	\$6.415	-	\$0.061	=	\$6.354	\$32.965	19.28%
1996	\$6.586	-	\$0.090	=	\$6.496	\$32.021	20.29%
1997	\$6.031	-	\$0.097	=	\$5.934	\$28.512	20.80%
1998	\$6.459	-	\$0.059	=	\$6.400	\$30.119	21.25%
1999	\$6.473	-	\$0.232	=	\$6.242	\$30.386	20.54%
2000	\$7.099	-	\$0.759	=	\$6.341	\$30.261	20.95%
2001	\$7.092	-	\$0.784	=	\$6.308	\$30.699	20.55%
2002	\$7.501	-	\$0.870	=	\$6.631	\$33.817	19.61%
2003	\$7.722	-	\$1.053	=	\$6.668	\$34.774	19.18%
2004	\$7.898	-	\$1.064	=	\$6.833	\$36.784	18.58%
Average (FY 2001 through FY 2004):							<u>19.48%</u>

Other operating expenses as a percent of gross receipts has remained stable over time, and is anticipated to remain at the four-year average from FY 2001 through FY 2004 of 19.48%.

Table 5 shows the calculation of total operating expenses for FY 2005 through FY 2007.

Table 5
Calculation of Operating Expenses (\$ millions)
FY 2004 through FY 2007

Fiscal Year	Gross Receipts	X	Other Operating Expenses % of Gross Receipts	=	Other Operating Expenses	+	Depreciation and Amortization	+	Cost Adjustment*	=	Total Operating Expenses
2005	\$34.626	X	19.48%	=	\$6.745	+	\$1.069	+		=	\$7.814
2006	\$34.820	X	19.48%	=	\$6.783	+	\$0.957	+	\$0.150	=	\$7.890
2007	\$35.004	X	19.48%	=	\$6.819	+	\$0.110	+	\$0.150	=	\$7.079

*FY 2006 and FY 2007 includes a cost adjustment of \$150,000 each year for equipment replacement and repair after the current lottery system is completely depreciated and amortized in March 2006.

Table 5 shows that based on the forecast gross receipts from Table 2, other operating expenses are forecast to be \$6.745 million in FY 2005; \$6.783 million in FY 2006; and \$6.819 million in FY 2007.

With the assistance of Lottery personnel, depreciation and amortization expenses are projected at \$1.069 million for FY 2005, \$0.957 million for FY 2005, and \$0.110 million for FY 2007. The expenses associated with depreciation and amortization are significantly lower in FY 2007 because the current lottery gaming system will be completely depreciated and amortized in March 2006. The cost to continue using the current system is significantly less than the amortization and depreciation schedules used through FY 2006. However, it is expected that there will be additional cost for equipment replacement and repair after the current lottery system is completely amortized and depreciated. The additional cost is anticipated to be \$150,000 in both FY 2006 and FY 2007.

Step 4: Calculate Net Transfers to the General Fund

The lottery revenue transfer to the general fund is gross receipts minus disbursements in prizes, commissions, and operating expenses. Table 6 shows forecast transfers to the general fund for FY 2005 through FY 2007. Lottery general fund revenue for the forecast period is \$7.002 million in FY 2005, \$7.009 million in FY 2006, and \$7.899 million in FY 2007.

Table 6 Projected Lottery General Fund Revenue (\$ millions) FY 2003 through FY 2005						
<u>Fiscal Year</u>	<u>Projected Gross Receipts</u>	-	<u>Projected Prizes and Commissions</u>	-	<u>Projected Operating Expenses</u>	= <u>Projected General Fund</u>
2005	\$34.626	-	\$19.810	-	\$7.814	= \$7.002
2006	\$34.820	-	\$19.920	-	\$7.890	= \$7.009
2007	\$35.004	-	\$20.026	-	\$7.079	= \$7.899

HIGHWAY PATROL FINES

Revenue Description

Highway patrol fines are provided for primarily in Title 61, Chapter 8, parts 3 and 7, MCA. Disposition of these fines is provided for in 3-10-601, 53-9-109, and 61-12-701, MCA. Generally, citations given out by highway patrolmen are collected in justice court, and are distributed 50% to the county general fund and 50% to the state general fund. This is provided for in 3-10-601, MCA.

Historical and Projected Revenues

Table 1 shows total collections and general fund revenue from highway patrol fines for FY 1994 through FY 2004 and forecast revenue for FY 2005 through FY 2007.

	Fiscal Year	Total	General Fund	Percent Change
A	1994	\$3.091	\$0.988	
A	1995	\$3.426	\$1.673	69.27%
A	1996	\$3.374	\$3.374	101.65%
A	1997	\$3.644	\$3.644	8.00%
A	1998	\$3.801	\$3.801	4.31%
A	1999	\$3.759	\$3.759	-1.11%
A	2000	\$4.028	\$4.028	7.16%
A	2001	\$3.981	\$3.981	-1.16%
A	2002	\$4.062	\$4.062	2.04%
A	2003	\$4.111	\$4.111	1.21%
A	2004	\$4.084	\$4.084	-0.64%
F	2005	\$4.287	\$4.287	4.95%
F	2006	\$4.370	\$4.370	1.94%
F	2007	\$4.453	\$4.453	1.90%

Fiscal Year	Total Collections (\$ millions)	General Fund (\$ millions)
1994	3.091	0.988
1995	3.426	1.673
1996	3.374	3.374
1997	3.644	3.644
1998	3.801	3.801
1999	3.759	3.759
2000	4.028	4.028
2001	3.981	3.981
2002	4.062	4.062
2003	4.111	4.111
2004	4.084	4.084
2005	4.287	4.287
2006	4.370	4.370
2007	4.453	4.453

The increase in general fund revenue in FY 1995 is due to a change in allocation. Before FY 1995, a portion of the state's share of highway patrol fines was allocated to a state special revenue fund. Since FY 1995, all highway patrol fines received by the state are deposited in the general fund.

Total collections have shown a general upward trend, with growth averaging a little less than \$0.1 million per year. Collections grew faster in FY 2000, the first full fiscal year when numeric speed limits were in effect. Other legislation does not appear to

have significantly affected collections. In particular, bills passed by the 2003 legislature raised maximum fines for several types of traffic offenses, lowered the blood alcohol level for driving under the influence, and made other changes. These changes did not result in revenue growth in FY 2004.

Forecast Methodology and Projection Calculation

The time trend of collections growth was estimated statistically using collections for FY 1996 through FY 2004. It was found that, on average, collections can be expected to grow by \$0.083 million per year. Collections are estimated by applying this annual growth beginning with the midpoint of the period used to estimate the trend, FY 2000, and the average of annual collections during the period, \$3.871 million. Table 2 shows the calculation of forecast collections for FY 2005 through FY 2007.

Table 2 Calculation of Forecast Collections FY 2004 through FY 2007 (\$ millions)						
<u>Fiscal Year</u>	<u>Years Since FY 2000</u>		<u>Annual Growth</u>		<u>Average Collections FY1996 - FY 2004</u>	<u>Forecast Collections</u>
F 2005	5	x	0.083	+	\$3.871	= \$4.287
F 2006	6	x	0.083	+	\$3.871	= \$4.370
F 2007	7	x	0.083	+	\$3.871	= \$4.453

INVESTMENT LICENSES AND PERMITS

Revenue Description

Persons who plan to sell securities in Montana must register with the State Auditor and pay fees as specified in 30-10-209, MCA. The fee to register as a broker-dealer or investment advisor is \$200 a year. The fee for salespersons and representatives working for a broker-dealer or investment advisor is \$50.

Newly issued securities that are not regulated at the federal level, traded on a regulated or self-regulating exchange, or otherwise exempt from state regulation must be registered with the State Auditor's office. The first year they are offered, the registration fee is \$200 plus 0.1% of the value over \$100,000, up to a maximum fee of \$1,000. In succeeding years, the registration may be renewed for a fee of 0.1% of the value of securities to be offered that year with a minimum of \$200 and a maximum of \$1,000.

Historical and Projected Revenues

Table 1 shows actual collections for investment licenses and permits for FY 1994 through FY 2004, and projected revenue for FY 2005 through FY 2007.

Table 1 Investment Licenses and Permits - General Fund Revenue (\$ millions)			
Fiscal Year	General Fund	Percent Change	
A 1994	\$3.000		
A 1995	\$3.099	3.30%	
A 1996	\$3.344	7.90%	
A 1997	\$3.710	10.96%	
A 1998	\$4.086	10.12%	
A 1999	\$4.413	8.02%	
A 2000	\$5.390	22.12%	
A 2001	\$5.889	9.26%	
A 2002	\$4.992	-15.23%	
A 2003	\$5.142	3.00%	
A 2004 ¹	\$4.334	-15.71%	
F 2005	\$4.123	-4.86%	
F 2006	\$3.923	-4.86%	
F 2007	\$3.733	-4.86%	

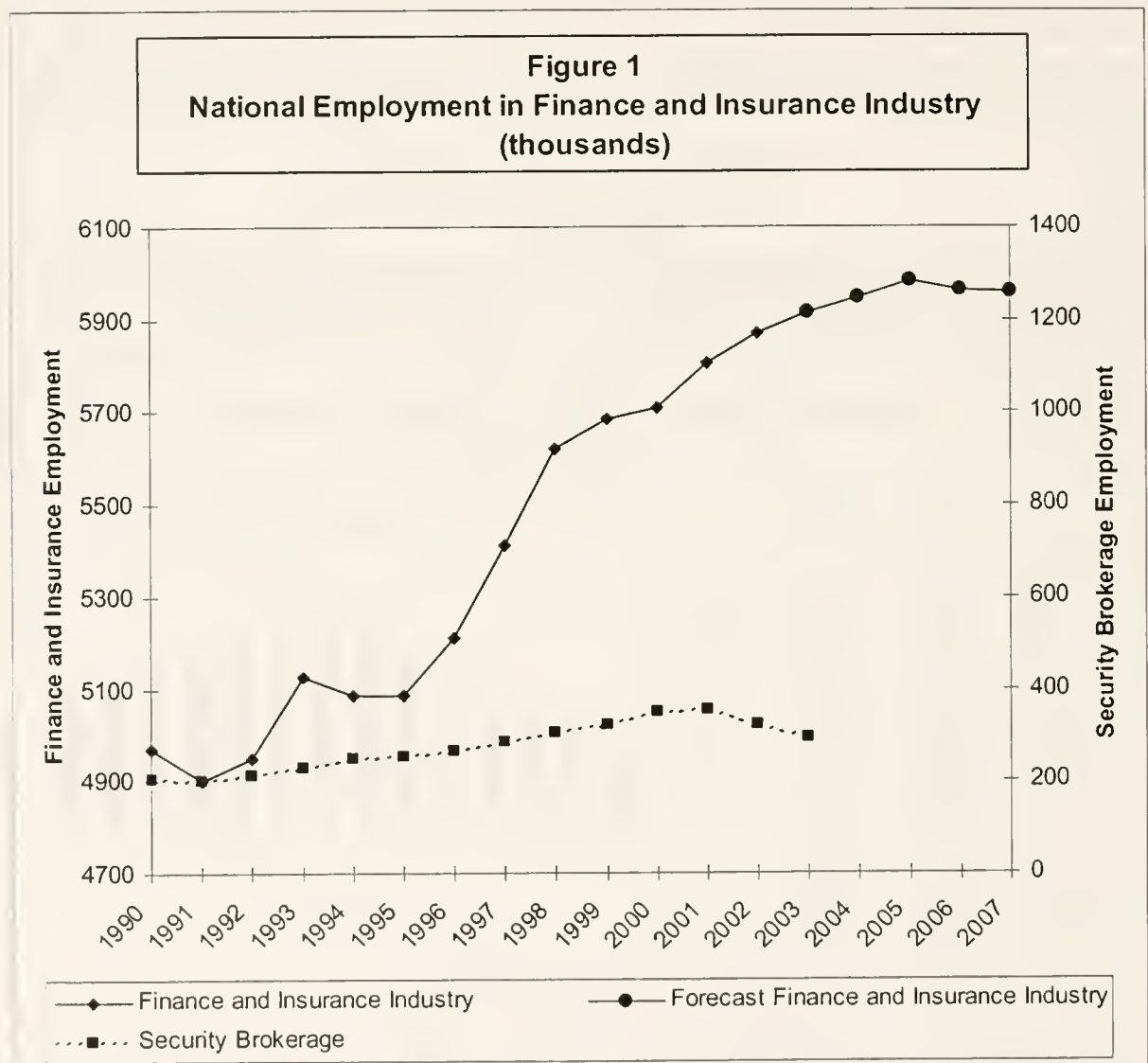
¹FY 2004 is revised collection amount. There was a miscoding of revenue of \$500,000.

Revenue grew rapidly during the stock market boom from 1994 through 2001 as more persons registered to sell securities. Following the stock market collapse, revenue has been lower and is projected to continue to decline toward the levels of the mid-1990s.

Forecast Methodology and Projection Calculation

The basic fee structure of securities licenses and permits has not changed during the period shown in Table 1. Revenue growth has resulted from increases in the number of securities licenses, and the value of state-regulated securities issued in Montana.

The security brokerage industry grew rapidly from 1990 through 2001, both nationally and in Montana. Figure 1 shows national employment in the security brokerage industry, and in the finance and insurance sector as a whole from 1990 through 2003, along with Global Insight's forecast of employment in the finance and insurance sector for 2004 through 2007. Employment in the finance and insurance sector is measured on the left axis, and employment in the security brokerage industry is measured on the right axis.



National employment in the security brokerage industry grew 83.3% from April 1991 to April 2001. Over one-quarter of that growth occurred in 2000 and 2001. National employment in the industry peaked in April 2001 and has declined by 20% since then. Investment license revenue peaked in FY 2001, at the same time that national employment in the industry peaked.

Global Insight does not forecast employment for the security brokerage industry, but does forecast employment for the finance and insurance sector. In 2003, about 5% of employment in the finance and insurance sector was in the security brokerage industry. Employment in the sector as a whole continued to grow through 2003. Global Insight expects employment in this sector to continue to grow slowly in 2004 and 2005, then decline slightly in 2006 and 2007.

Growth of the securities brokerage industry through early 1991 was fueled by the run up in stock prices, and by an increase in the number of people participating in financial markets. As people saw significant increases in the value of their financial portfolios, they were willing to pay for more services from brokerage firms such as financial advice and frequent securities trades to take advantage of changes in the market.

With the decline in the stock market in 2001, individuals have been less willing to pay for some of the extra services that they bought during the 1990s. At the same time, there have been significant increases in productivity in supplying basic brokerage services. Customers can place orders online and the processing of trades has become more automated. Customers can buy and sell securities with less labor cost per transaction than in the past.

The result of all these changes is declining employment in the security brokerage industry. This is reflected in security license revenue, which fell by 15.2% in FY 2002, grew slowly in FY 2003, and then declined again by 15.7% in FY 2004. The average annual change from FY 2001 through FY 2004 is -9.7%.

Over the next several years, demand for services of the security brokerage industry is likely to show little growth, and productivity is likely to continue to grow as automation of routine processes in the industry continues to expand. This will cause employment to continue to drop, but not as quickly as in 2002 and 2003. National employment in the security brokerage industry decreased by 8.4% in 2003. If employment decreases at half that rate over the next three years, it will be about the same in 2007 as in 1994. For purposes of this analysis, it is assumed that revenue will decrease 4.86%, or at half the average annual change in revenue observed from FY 2001 to FY 2004 ($-9.7\% \div 2$).

PUBLIC CONTRACTORS' GROSS RECEIPTS TAX

Revenue Description

Section 15-50-101, MCA, provides for a 1% tax on the gross receipts contractors receive for construction work within the state for federal, state, or local governments. Contractors may use the amount of gross receipts tax paid as an offset, or credit, against either their corporation license tax or their individual income tax. In addition, any personal property taxes paid on property located within Montana and used in the contractor's business may be used to obtain a refund of contractors' gross receipts taxes paid. Any tax not credited or refunded is general fund revenue.

Historical and Projected Revenues

Table 1 shows historical and forecast public contractors' gross receipts tax general fund revenue for FY 1994 through FY 2007.

Table 1 Public Contractors' Gross Receipts Tax - General Fund Revenue (\$ millions)			
	<u>Fiscal Year</u>	<u>General Fund</u>	<u>Percent Change</u>
A	1994	\$0.964	
A	1995	\$1.192	23.67%
A	1996	\$1.621	35.98%
A	1997	\$1.964	21.12%
A	1998	\$2.291	16.66%
A	1999	\$3.320	44.94%
A	2000	\$2.162	-34.88%
A	2001	\$0.792	-63.39%
A	2002	\$3.267	312.74%
A	2003	\$3.082	-5.67%
A	2004	\$2.120	-31.21%
F	2005	\$1.956	-7.76%
F	2006	\$2.605	33.23%
F	2007	\$2.400	-7.90%

Public Contractors' Gross Receipt Tax

Fiscal Year	General Fund Revenue (\$ millions)
1994	0.964
1995	1.192
1996	1.621
1997	1.964
1998	2.291
1999	3.320
2000	2.162
2001	0.792
2002	3.267
2003	3.082
2004	2.120
2005	1.956
2006	2.605
2007	2.400

The FY 1999 general fund revenue growth of 45% and the FY 2000 general fund revenue reduction of 35% are due to processing credits and refunds that normally would have occurred in FY 1999, but were moved to FY 2000. This increases revenue collections in FY 1999 by \$400,000 and decreases collections in FY 2000 by the same amount. An undeterminable amount of refunds attributable to FY 2002 and FY 2003 were not processed during the year, causing general fund revenue to increase significantly in these years. During FY 2004 and FY 2005, the Department of Revenue is processing the backlog of credits and refunds.

In FY 2005 through FY 2007, two significant factors will affect this tax revenue: (1) the amount of credits and refunds will be above average in FY 2005 as the Department of Revenue will still be processing the backlog, and (2) the Department of Transportation (DOT) contracts are estimated to increase through FY 2006 and then decrease in FY 2007.

Forecast Methodology and Projection Calculation

There are three steps to calculate the public contractors' gross receipt tax: 1) forecast gross tax receipts; 2) forecast total credits and refunds; and 3) subtract credits and refunds from gross receipts to obtain the general fund revenue.

Gross Tax Receipts

Public contractors' gross tax receipt collections depend foremost on the volume of public contracts being let in any year. These contracts stem from allocations of federal highway funds, forest service construction contracts, state and federal building programs, etc.

Table 2 shows actual and projected contractors' gross receipt payments for FY 1994 through FY 2007 from DOT and other contractors. DOT projects payments from the department to be \$3.0 million in FY 2005, \$3.4 million in FY 2006, and \$2.9 million in FY 2007. Other contractor payments grew from \$1.7 million in FY 1994 to \$3.9 million in FY 1999. Since FY 1999, however, other contract payments have fluctuated. Other contractor payments for FY 2005 through FY 2007 are estimated at the average level observed from FY 1999 through FY 2004, which is \$3.1 million.

Table 2 Gross Receipts Payments FY 1994 through FY 2007				
<u>FY</u>	<u>Gross Receipt</u>		<u>Department of Transportation</u>	<u>Other Contractor</u>
A 1994	\$3,136,003	=	\$1,431,612	+ \$1,704,391
A 1995	\$3,737,970	=	\$1,406,977	+ \$2,330,993
A 1996	\$4,190,369	=	\$1,709,662	+ \$2,480,707
A 1997	\$4,475,513	=	\$1,697,389	+ \$2,778,124
A 1998	\$4,967,149	=	\$1,733,207	+ \$3,233,942
A 1999	\$5,901,753	=	\$2,006,456	+ \$3,895,297
A 2000	\$5,516,069	=	\$2,348,755	+ \$3,167,314
A 2001	\$4,502,749	=	\$2,005,080	+ \$2,497,669
A 2002	\$5,054,973	=	\$2,177,490	+ \$2,877,483
A 2003	\$5,706,437	=	\$2,376,404	+ \$3,330,033
A 2004	\$6,099,524	=	\$2,539,021	+ \$3,040,063
F 2005	\$6,138,940	=	\$3,004,297	+ \$3,134,643
F 2006	\$6,513,550	=	\$3,378,907	+ \$3,134,643
F 2007	\$5,999,088	=	\$2,864,445	+ \$3,134,643

Tax Credits and Refunds

Public contractors may or may not be able to utilize the contractors' gross receipts tax as a credit offset against individual income taxes, depending on their profit and

loss situation each year. Corporation license tax credits also vary significantly from year to year, and are very difficult to predict with any great accuracy. Total credits for public contractors' gross receipts tax is the sum of individual income tax and corporation license tax credits.

Companies may receive personal property tax and overpayment refunds on the gross receipts tax that they pay. The bulk of these refunds are for class 8 business equipment property and automobiles. The amount of property tax refunds in any year is influenced by changes in the level of property used in the state and by the property tax rates. Property tax refunds starting in FY 2002 should reflect a decrease in refunds from normal trends as a result of SB 200 (1999), HB 540 (1999), and HB 4 (2000 special session). SB 200 reduced the taxable valuation rate applied to personal property by half, from 6% to 3%, beginning January 1, 2000. HB 540 and HB 4 eliminated the 1.4% ad valorem tax and the 1.5% "new car" sales tax, beginning January 1, 2001, and replaced these two ad valorem taxes with a three-tier flat fee. With the processing fluctuations between years, it is impossible to detect any trends and the impact of legislation reducing the business equipment and vehicle property taxes.

Table 3 shows actual credits and refunds processed for FY 1994 through FY 2004 and projections for FY 2005 through FY 2007. Credits estimated for FY 2006 to FY 2007 are 60% of gross receipts shown in Table 2. The average of the total credits and refunds during this period is 57.2% without the unprocessed backlog. FY 2005 has an extra \$500,000 of refunds, which is approximately half of the unprocessed individual income tax credits and none of the unprocessed property tax refunds at the beginning of the fiscal year. The assumption is that at fiscal year end there will always be some refunds to process, and the accounting procedures will not change to accrue these refunds.

Fiscal Year	Credits	Refunds	Total Credits/Refunds
A 1994	\$0.747	\$1.350	\$2.096
A 1995	\$1.235	\$1.311	\$2.546
A 1996	\$1.153	\$1.415	\$2.569
A 1997	\$0.980	\$1.532	\$2.512
A 1998	\$0.624	\$2.053	\$2.677
A 1999	\$1.013	\$1.569	\$2.582
A 2000	\$1.518	\$1.927	\$3.445
A 2001	\$1.840	\$1.871	\$3.711
A 2002	\$1.710	\$0.523	\$2.233
A 2003	\$0.828	\$1.736	\$2.564
A 2004	\$2.377	\$1.602	\$3.979
F 2005			\$4.183
F 2006			\$3.908
F 2007			\$3.599

Public Contractors' Tax Credits and Refunds

Fiscal Year	Total Credits and Refunds
1994	2.096
1995	2.546
1996	2.569
1997	2.512
1998	2.677
1999	2.582
2000	3.445
2001	3.711
2002	2.233
2003	2.564
2004	3.979
2005	4.183
2006	3.908
2007	3.599

Net General Fund Revenue

General fund revenue is the gross tax collections minus tax credits and refunds. As shown in Table 4, public contractors' gross receipts tax general fund revenue is estimated at \$1.956 million in FY 2005, \$2.605 million in FY 2006, and \$2.400 million in FY 2007.

Table 4					
Public Contractors' Gross Receipts Tax					
General Fund Revenue					
Fiscal Year	Gross Tax Collections	-	Total Credits/Refunds	=	General Fund Collections
F 2005	\$6.139	-	\$4.183	=	\$1.956
F 2006	\$6.514	-	\$3.908	=	\$2.605
F 2007	\$5.999	-	\$3.599	=	\$2.400

DRIVER'S LICENSE FEES

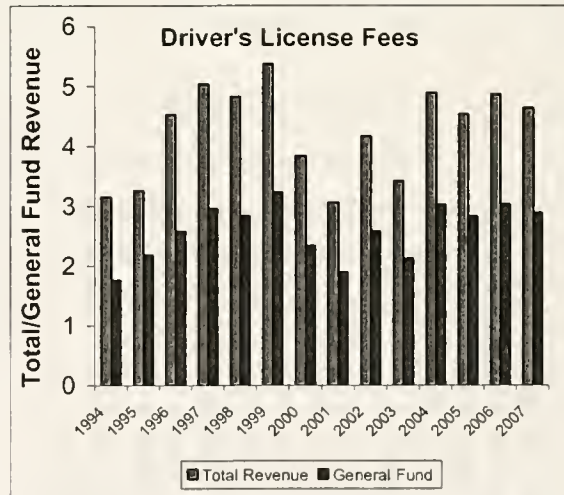
Revenue Description

Fees for driver's licenses, commercial driver's licenses, and motorcycle endorsements are set in 61-5-111, MCA. The fee for replacing a lost or destroyed license is set in 61-5-114, MCA. The distribution of revenue from driver's license fees is set in 61-5-121, MCA. Fees for original and replacement licenses are allocated to the state general fund, the traffic education account, and the highway patrol retirement fund. Commercial driver's license fees are allocated to the general fund. Motorcycle endorsement fees are allocated to the state general fund and the motorcycle safety account. Counties retain a small percentage of fees that they collect.

Historical and Projected Revenue

Table 1 shows actual collections for FY 1994 through FY 2004 and forecast collections through FY 2007.

<u>Fiscal Year</u>	<u>Total Revenue</u>	<u>Percent Change</u>	<u>General Fund</u>	<u>Percent Change</u>
A 1994	3.151		1.755	
A 1995	3.260	3.4%	2.184	24.4%
A 1996	4.525	38.8%	2.574	17.8%
A 1997	5.034	11.2%	2.954	14.7%
A 1998	4.824	-4.2%	2.828	-4.3%
A 1999	5.372	11.4%	3.234	14.4%
A 2000	3.836	-28.6%	2.333	-27.8%
A 2001	3.063	-20.2%	1.896	-18.8%
A 2002	4.173	36.3%	2.580	36.1%
A 2003	3.421	-18.0%	2.119	-17.8%
A 2004	4.895	43.1%	3.021	42.6%
F 2005	4.537	-7.3%	2.825	-6.5%
F 2006	4.868	7.3%	3.031	7.3%
F 2007	4.634	-4.8%	2.886	-4.8%



Total collections and the general fund share have been affected by significant legislative changes. In FY 1995 the general fund share of driver's license fees was increased. Beginning in FY 1996, portions of motorcycle endorsements and duplicate license fees were allocated to the general fund.

In October 1995, the state began a process of converting from four-year licenses to eight-year licenses. Between October 1995 and October 1999, half of licenses issued were four-year licenses and half were eight-year licenses, with the fee for an eight-year license being twice the fee for a four-year license. During this period, the number of licenses was the same as it would have been with no change in the law - new drivers and new residents got new licenses and about one-fourth of existing drivers renewed their licenses each year. However, the average revenue per license was higher because half of renewals were paying the higher eight-year license fee. Beginning in October 1999, all licenses for drivers between 21 and 68 years old are eight-year licenses. Between October 1999 and October 2003, drivers who received four-year licenses between October 1995 and October 1999 were required to renew. On average, renewals were half of what they would have been without the change, but the fee for each renewal license was higher.

This transition process resulted in temporarily higher revenue in FY 1996 through FY 1999. The transition also produced a pattern of annual fluctuations in revenue from FY 1996 through FY 2003. Revenue was significantly higher in FY 1997 and FY 1999 than in FY 1996 and FY 1998. Although four-year and eight-year licenses were issued on alternate days, it appears that the proportion of four-year and eight-year licenses varied between years, probably because holidays and the less busy days of the week fell on four-year license days more often in FY 1997 and FY 1999 than in the other two years. In FY 2001 and FY 2003, when four-year licenses issued in FY 1997 and FY 1999 were being renewed, revenue was significantly lower than in FY 2000 and FY 2002, when four-year licenses issued in FY 1996 and FY 1998 were being renewed.

Beginning July 1, 2004, fees for noncommercial driver's licenses were raised from \$4 to \$5 per year. A renewal notice fee of \$0.50 was imposed beginning October 1, 2004. These changes increased revenue in FY 2004.

Forecast Methodology and Projection Calculation

Base driver's license revenue is estimated from detailed information on state population by age. Commercial driver's license, motorcycle endorsement, and replacement license revenue have been roughly proportional to base driver's license revenue. They are forecast to continue to be collected in these proportions.

Table 2 shows revenue from each type of fee and total revenue from FY 1994 through FY 2004.

Table 2 Revenue by Type of License FY 1994 through FY 2004 (\$ millions)					
Fiscal Year	Basic Driver's License	Commercial Licenses	Motorcycle Endorsement	Duplicate License	Total Revenue
1994	\$2.910	\$0.212	\$0.030	\$0.000	\$3.151
1995	\$3.005	\$0.222	\$0.032	\$0.000	\$3.260
1996	\$3.980	\$0.331	\$0.041	\$0.071	\$4.424
1997	\$4.403	\$0.375	\$0.046	\$0.091	\$4.914
1998	\$4.211	\$0.358	\$0.040	\$0.090	\$4.699
1999	\$4.808	\$0.414	\$0.053	\$0.098	\$5.372
2000	\$3.320	\$0.351	\$0.038	\$0.126	\$3.836
2001	\$2.573	\$0.340	\$0.028	\$0.122	\$3.063
2002	\$3.470	\$0.517	\$0.042	\$0.144	\$4.173
2003	\$2.852	\$0.366	\$0.031	\$0.173	\$3.421
2004	\$4.130	\$0.421	\$0.040	\$0.304	\$4.895

The fee for a basic driver's license is \$5.00 per year. Motorcycle endorsement is an additional \$0.50 per year. Commercial licenses are an additional \$3.50 per year for an intrastate license and \$5.00 per year for an interstate license. With each license, there is an additional fee of \$0.50 for mailing a renewal notice before it expires.

Drivers of different ages are licensed for different numbers of years and therefore pay different fees. Learner's permits expire after six months. Drivers under 21 are issued a license that expires on their twenty-first birthday. Drivers between 21 and 67 years of age are issued eight-year licenses. Drivers between 68 and 75 years of age are issued a license that expires on their seventy-fifth birthday. Drivers over 75 years of age are issued four-year licenses. Table 3 shows the fees drivers of different ages pay for their licenses.

Table 3 Driver's License Fees		
-----Base License-----		
Age/Type	Term	Fee
Learner's Permit	6 months	\$5.50
Under 21	to 21st birthday	\$5/yr + \$0.50
Age 21 - 67	8 years	\$40.50
Age 68 - 74	to 75th birthday	\$5/yr + \$0.50
Age 75 and Over	4 years	\$20.50
-----Additional Fees-----		
Motorcycle		\$0.50/yr
Commercial - Intrastate Only		\$3.50/yr
Commercial - Interstate		\$5.00/yr

The 2003 legislature made two changes to license fees. The fee for a basic license was increased from \$4.00 to \$5.00 per year effective July 1, 2003. The additional fee of \$0.50 for renewal notices went into effect October 1, 2003. Table 4 shows the fees drivers of different ages paid for a base driver's license before and after these changes. No fee changes are scheduled through the end of FY 2007.

Table 4
Base Driver's License Fees
FY 2000 through FY 2007

Fiscal Years	Age 15 Learner's Permit	Age 16 5 Year License	Ages 21 through 61 8 Year License	Age 69 6 Year License	Ages 75 and Over 4 Year License
Through June 30, 2003	\$4.00	\$20.00	\$32.00	\$24.00	\$16.00
July 1, 2003 - September 30, 2003	\$5.00	\$25.00	\$40.00	\$30.00	\$20.00
October 1, 2003 and After	\$5.50	\$25.50	\$40.50	\$30.50	\$20.50

To estimate revenue from driver's license fees, it is necessary to estimate the number of drivers who will pay each level of fee each year. Table 5 shows estimates of Montana population eligible for a new or renewed license in the five age groups shown in Table 4. The middle group is the sum of population at the ages where someone who renewed their license at age 21 would need to renew again. Through FY 2003, the population estimates are from the Census Bureau. Estimates for FY 2004 through FY 2007 were developed from the Census Bureau estimates. The FY 2004 population of 16 year olds was estimated by multiplying the FY 2003 population of 15 year olds by the average ratio of 16 year olds in one year to 15 year olds in the previous year, which is 1.0037. This ratio means that, because of the combination of people moving into and out of the state and dying, for every 1,000 fifteen year olds in Montana this year, there will be about 1,004 sixteen year olds next year. A similar calculation was used to estimate future populations at other ages.

Table 5
Population at Ages to Obtain or Renew Driver's Licenses
FY 2000 through FY 2007

Fiscal Year	Age 15	Age 16	Ages 21, 29, 37, 45, 53, and 61	Age 69	Ages 75, 79, and 83
A 2000	14,547	14,558	71,586	6,452	13,440
A 2001	14,004	14,302	72,398	6,264	13,387
A 2002	13,714	14,141	71,691	6,268	13,458
A 2003	13,559	13,758	73,327	6,363	13,200
A 2004	13,379	13,610	73,652	6,752	13,851
F 2005	13,679	13,471	74,801	6,837	13,798
F 2006	13,389	13,788	75,369	6,858	13,706
F 2007	13,195	13,584	75,023	7,291	13,552

Table 6 shows the populations eligible for a license in Table 5 multiplied by the license fees in Table 4.

Table 6 Population at Ages to Obtain or Renew Driver's Licenses Multiplied by Average Fee						
Fiscal Year	Learner's Permit	5 Year License	8 Year License	6 Year License	4 Year License	Total
A 2000	\$58,188	\$291,160	\$2,290,752	\$154,848	\$215,040	\$3,009,988
A 2001	\$56,016	\$286,040	\$2,316,736	\$150,336	\$214,192	\$3,023,320
A 2002	\$54,856	\$282,820	\$2,294,112	\$150,432	\$215,328	\$2,997,548
A 2003	\$54,236	\$275,160	\$2,346,464	\$152,712	\$211,200	\$3,039,772
A 2004	\$71,912	\$345,350	\$2,973,688	\$205,095	\$282,222	\$3,878,266
F 2005	\$75,236	\$343,522	\$3,029,429	\$208,515	\$282,852	\$3,939,554
F 2006	\$73,637	\$351,589	\$3,052,447	\$209,182	\$280,980	\$3,967,835
F 2007	\$72,572	\$346,393	\$3,038,445	\$222,374	\$277,812	\$3,957,596

Table 7 compares the totals for FY 2000 through FY 2004 from Table 6 to actual collections in those years.

The top part of the table shows population times fees, actual revenue, and the ratio of actual revenue to population times fees for FY 2000 through FY 2004. This ratio is higher than 100% in even numbered fiscal years and lower than 100% in odd numbered fiscal years, reflecting the renewal of the varying number of eight-year licenses issued between FY 1996 and FY 1999. The difference between even and odd numbered years appears to be decreasing over time.

Table 7 Population Times Fees v. Actual Revenue			
Fiscal Year	Population x Fees	Revenue	Revenue / Population x Fees
A 2000	\$3,009,988	\$3,319,750	110.29%
A 2001	\$3,023,320	\$2,572,685	85.09%
A 2002	\$2,997,548	\$3,469,811	115.75%
A 2003	\$3,039,772	\$2,851,971	93.82%
A 2004	\$3,878,266	\$4,129,977	106.49%
Average Ratio 2001 - 2004			100.29%

The lower part of the table shows the average ratio for FY 2001 through FY 2004. This ratio is slightly higher than 100% because new residents, who must get a new license regardless of their age, slightly outnumber non-drivers on average.

Table 8, on the next page, shows the forecast of revenue from base driver's license fees. The second column shows the total of population needing a new license multiplied by fees from Table 6. The third column shows forecast ratios of revenue to population times fees for FY 2005 through FY 2007. The annual swings in

revenue are expected to continue but to decrease further over time. The ratios in FY 2005 and FY 2006 are half as far from the average as the ratios in FY 2003 and FY 2004. The ratio in FY 2007 is half as far from the average as the ratio in FY 2005. The right-hand column shows the forecast of revenue from basic license fees, which is the product of population times fees in the second column and the ratio in the third column.

Table 8 Population Times Fees and Forecast Basic License Revenue FY 2005 through FY 2007			
Fiscal Year	Population x Fees	Revenue / Population x Fees	Revenue
F 2005	\$3,939,554	97.06%	\$3,823,580
F 2006	\$3,967,835	103.39%	\$4,102,360
F 2007	\$3,957,596	98.67%	\$3,905,091

Fees for commercial driver's licenses, motorcycle endorsements and duplicate licenses have maintained fairly stable proportions to base license fees. Table 9 shows the ratios of revenue from these fees to revenue from base licenses for FY 2000 through FY 2004 and the average over this period.

Table 9 Ratios of Commercial, Motorcycle, and Duplicate Fees to Base License Fees			
Fiscal Year	Commercial Licenses	Motorcycle Endorsement	Duplicate License
A 2000	10.59%	1.16%	3.81%
A 2001	13.23%	1.08%	4.73%
A 2002	14.91%	1.20%	4.15%
A 2003	12.83%	1.07%	6.05%
A 2004	10.19%	0.98%	7.36%
Average	12.35%	1.10%	5.22%

Future collections are forecast to equal the average percentages of base license fees. Table 10 shows the forecasts of collections from each fee and the total.

Table 10 Forecast Driver's License Fees (\$ millions)					
Fiscal Year	Basic Driver's License	Commercial Licenses	Motorcycle Endorsement	Duplicate License	Total
F 2005	3.824	0.472	0.042	0.200	4.537
F 2006	4.102	0.507	0.045	0.214	4.868
F 2007	3.905	0.482	0.043	0.204	4.634

When driver's license fees are collected by a county, the county retains 2.5% of base license fees and commercial driver's license fees, 3.34% of motorcycle endorsement fees, and 3.75% of duplicate license fees. This revenue is not received by the state, and is not included in the estimates in Table 10. However, the allocation of driver's license fees is based on the total amount collected, not just the part received by the state. The Highway Patrol Retirement Fund receives 22.3% of base license fees and 25% of duplicate license fees. The Traffic Education Account is allocated 20.7% of base license fees and 8.75% of duplicate license fees. The Motorcycle Safety Account receives 63.46% of motorcycle endorsement fees. The remainder is allocated to the general fund.

Table 11 shows the percentage of revenue received by the state allocated to each fund in FY 2004. These percentages are not expected to change.

Table 11 Driver's License Fees Allocation Percentages				
	Basic Driver's License	Commercial Licenses	Motorcycle Endorsement	Duplicate License
General Fund	57.57%	100.00%	36.51%	68.50%
Highway Patrol Retirement Fund	21.82%	0.00%	0.00%	25.86%
Traffic & Safety Education	20.61%	0.00%	0.00%	5.64%
Motorcycle Safety Training	0.00%	0.00%	63.49%	0.00%

Table 12 shows forecast driver's license fees allocated to the four funds in FY 2005 through FY 2007.

Table 12 Driver's License Fee Allocation FY 2004 through FY 2007 (\$ millions)					
Fiscal Year	General Fund	Highway Patrol Retirement Fund	Traffic & Safety Education	Motorcycle Safety Training	Total
F 2005	\$2.825	\$0.886	\$0.799	\$0.027	\$4.537
F 2006	\$3.031	\$0.951	\$0.858	\$0.029	\$4.868
F 2007	\$2.886	\$0.905	\$0.816	\$0.027	\$4.634

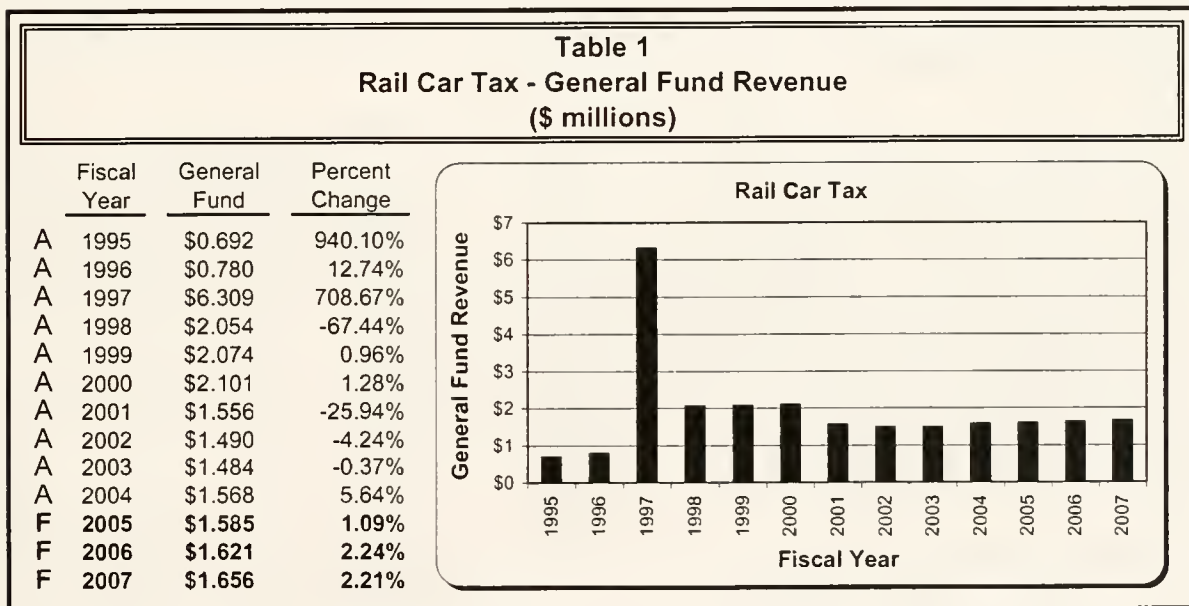
RAIL CAR TAX

Revenue Description

Section 15-23-101, MCA, provides for the central assessment of rail car companies' operating properties. The rail car tax is a tax assessed on a calculated taxable value of the rolling stock of freight line companies. Section 15-23-214, MCA, states that the tax shall be computed by multiplying the taxable value of the property by the average statewide mill levy for commercial and industrial property. Section 15-23-211, MCA, provides the definition of the average statewide mill levy. The general fund receives 100% of the rail car tax revenue.

Historical and Projected Revenue

Table 1 shows the historical and projected general fund revenue for the rail car tax.



The large increase in general fund collections in FY 1997 stems from a settlement agreement reached with a group of rail car companies, which brought in revenue due from prior years. HB 128, HB 174, SB 111, and SB 200, passed during the 1999 legislative session, caused a decrease in FY 2001 general fund revenue primarily due to the decline in the class 12 tax rate.

The class 12 taxable valuation rate, which applies to railroad and airline property, is a composite rate reflective of the weighted average tax rate applied to all commercial and industrial property in the state. The class 12 taxable valuation rate for FY 2001 through FY 2004 decreased significantly from the FY 2000 tax rate due

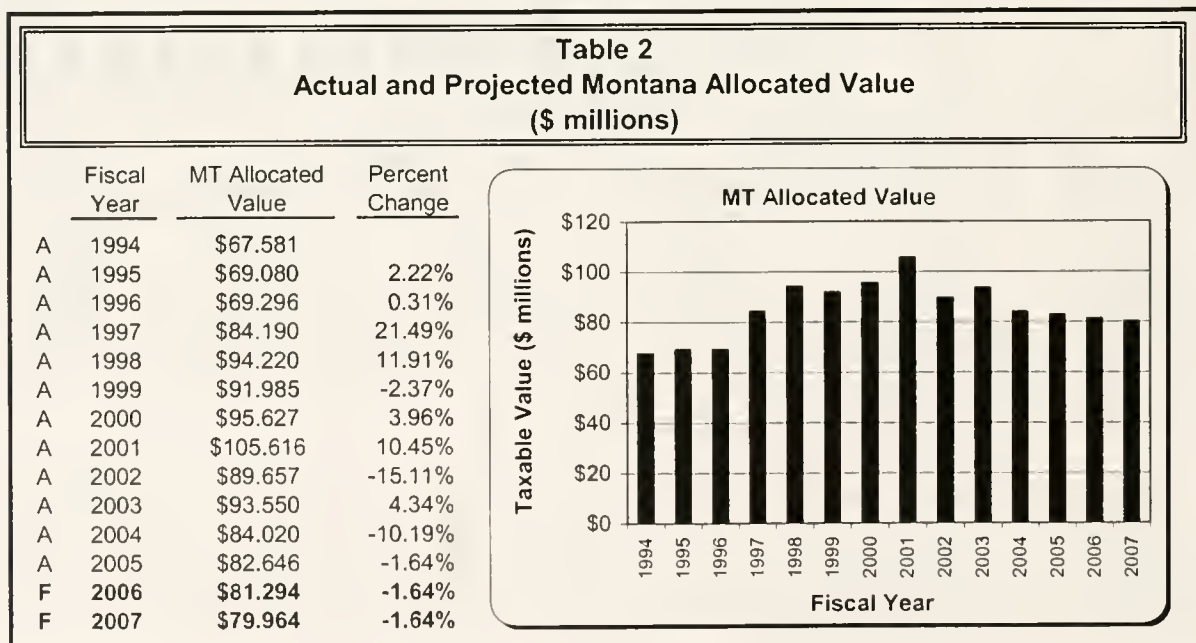
to the impacts of HB 128, HB 174, and SB 200 on taxable valuations of classes 7, 8, and 9 properties. The class 7 taxable value decrease is attributable to HB 128; portions of class 7 properties that had an 8% tax rate moved into class 5, which has a 3% tax rate. The class 8 taxable value decrease is attributable to SB 200, which reduced the tax rate from 6% to 3%. The class 9 taxable value decrease is attributable to HB 128 and HB 174. These two bills formed a new property class 13, which has a 6% tax rate, and is comprised of telecommunication mileage, electrical energy generation property, and other real and personal property that previously were class 9 properties taxed at a 12% tax rate.

Forecast Methodology and Projected Calculation

Calculation of rail car tax liability is a three-step process. The first step is to project Montana's allocated market value of rail car companies. The second step is to calculate the taxable value by applying the class 12 taxable valuation rate to Montana's allocated market value. The third step is to apply the statewide average mill levy for commercial and industrial property to the taxable value.

Step 1: Calculate Montana Market Value

The first step to project total rail car tax revenues is to estimate Montana's allocated market value for rail car companies. As Table 2 shows, Montana's allocated market value has fluctuated in recent years. Montana allocated value in future years is expected to decline slightly from the FY 2005 amount of \$82.646 million, which is the January 1, 2004, market value. Montana allocated value from FY 2004 to FY 2005 decreased by 1.64%. It is anticipated that Montana's allocated values will continue to decrease by 1.64% each year in FY 2006 and FY 2007.

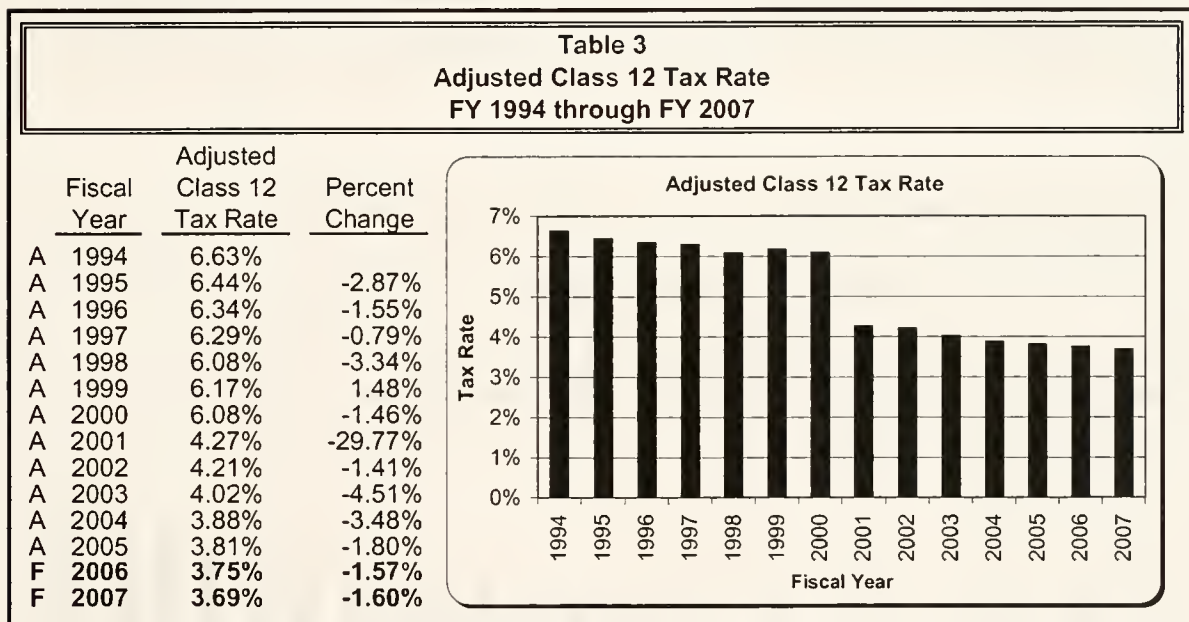


Step 2: Calculate Class 12 Taxable Valuation Rate

The second step in calculating rail car tax liability is to calculate the taxable value by applying the class 12 taxable valuation rate to Montana's allocated market value. The class 12 taxable valuation rate, which applies to railroad and airline property, is a composite rate reflective of the weighted average tax rate applied to all commercial and industrial property in the state. The class 12 tax rate calculation also includes an adjustment to class 4 commercial property based on the ratio of sales price to market value of class 4 commercial property.

The class 12 taxable valuation rate has significantly decreased since FY 2000 due to the impacts of HB 128, HB 174, and SB 200 on taxable valuations of classes 7, 8, and 9 properties.

The class 12 tax rate in FY 2005 (tax year 2004) was 3.81%. Using estimated commercial property valuations, the class 12 tax rate is estimated to be 3.75% in FY 2006 and 3.69% in FY 2007. Table 3 shows historical and projected class 12 tax rates from FY 1994 to FY 2007.



Step 3: Calculate Statewide Average Commercial/Industrial Property Mill Levy

The third step in calculating rail car tax liability is to determine the statewide average mill levy for commercial and industrial property. Section 15-23-211, MCA, provides a definition of the "average levy." Prior to FY 2004, the rail car tax was calculated using 95% of the average commercial statewide mill levy. Under current law, the rail car tax calculation for FY 2004 and beyond is calculated at 100% of the average statewide mill levy.

Statewide, mill levies generally increased in FY 2001 through FY 2004. Local governments can have local elections to increase mill levies, or, under 15-10-420, MCA, may float mill levies to produce the same amount of property tax revenue as the taxing jurisdiction received in the previous year, plus a growth rate of one-half the rate of inflation. Because statewide taxable valuations under HB 128, HB 174, and SB 200 have decreased from their FY 2000 levels, mill levies are increased to offset some of this taxable value decline.

As Table 4 shows, the average mill levy applicable for FY 2004 was 474.43 mills. FY 2004 was the first year that the full average statewide mill levy is used to calculate the rail car tax; prior years used 95% of the levy. The change, from using 95% of the average commercial mill levy to using the full average commercial mill levy, explains much of the increase shown in Table 4 from FY 2003 to FY 2004.

Fiscal year average commercial mill levies are based on prior tax year information. For example, the FY 2005 mill levy is based on tax year 2003 property tax information. As Table 4 shows, the average statewide commercial mill levy for FY 2005 is 503.39. The FY 2006 average commercial mill levy has not yet been calculated by the Department of Revenue. This forecast assumes that the average statewide mill levy for FY 2006 and FY 2007 will grow at 5.6%, which is the average annual growth rate of the *full* average statewide commercial mill levy from FY 2001 to FY 2005.

Table 4 shows the applicable actual and projected average statewide mill levies for commercial and industrial property for FY 1994 through FY 2007.

	Fiscal Year	Average Mill Levy	Percent Change
A	1994	295.06	
A	1995	314.34	6.53%
A	1996	327.84	4.29%
A	1997	351.13	7.10%
A	1998	359.94	2.51%
A	1999	365.34	1.50%
A	2000	363.54	-0.49%
A	2001	380.06	4.54%
A	2002	400.98	5.51%
A	2003	419.25	4.56%
A	2004	474.43	13.16%
A	2005	503.39	6.10%
F	2006	531.58	5.60%
F	2007	561.35	5.60%

*Under law, the average statewide mill levy (ASML) used in these calculations is required to go from 95% of the ASML to 100% beginning in fiscal 2004. This explains the significant increase in fiscal 2004.

Step 4: Calculate General Fund Revenue

As shown in Table 5, rail car tax revenue is determined by multiplying Montana's allocated rail car value by the class 12 tax rate, then multiplying by the average statewide mill levy for commercial and industrial property. General fund revenue is estimated at \$1.585 million in FY 2005, \$1.621 million in FY 2006, and \$1.656 million in FY 2007.

Table 5			
Calculation of Rail Car Tax General Fund Revenue			
FY 2005 through FY 2007			
Description	FY 2005	FY 2006	FY 2007
Total Montana Allocated Value	\$82,645,528	\$81,293,644	\$79,963,874
Multiply by Class 12 Tax Rate	3.81%	3.75%	3.69%
Taxable Value	\$ 3,148,795	\$ 3,048,512	\$ 2,950,667
Multiply by Mill Levy	0.50339	0.53158	0.56135
General Fund Revenue	\$ 1,585,072	\$ 1,620,527	\$ 1,656,352

ESTATE TAX

Revenue Description

The federal estate tax provides a credit for state inheritance or estate taxes. The Montana estate tax is equal to the maximum credit allowed under the federal tax. The state inheritance tax was repealed by the passage of Legislative Referendum 116, and does not apply for deaths occurring on or after January 1, 2001. The federal deduction is being phased out, and there will be no estate tax for deaths on or after January 1, 2005.

Historical and Projected Revenue

Table 1 shows actual estate and inheritance tax collections for FY 1994 through FY 2004 and projected collections for FY 2005 through FY 2007. Collections through FY 2001 show a general upward trend with year-to-year variations. Collections decreased in FY 2002 through FY 2004 and are projected to continue to decrease.

Table 1
Estate and Inheritance Taxes - General Fund Revenue
(\$ millions)

	<u>Fiscal Year</u>	<u>General Fund</u>	<u>Percent Change</u>
A	1994	\$ 10.886	-15.41%
A	1995	\$ 15.382	41.31%
A	1996	\$ 15.404	0.14%
A	1997	\$ 14.562	-5.46%
A	1998	\$ 15.727	7.99%
A	1999	\$ 18.302	16.38%
A	2000	\$ 19.003	3.83%
A	2001	\$ 20.286	6.75%
A	2002	\$ 13.816	-31.89%
A	2003	\$ 13.306	-3.69%
A	2004	\$ 11.431	-14.09%
F	2005	\$ 5.171	-54.77%
F	2006	\$ 2.301	-55.50%
F	2007	\$ 1.651	-28.26%



Forecast Methodology and Projection Calculation

Inheritance and estate tax collections are affected by the growth in number and value of estates and by recent law changes. There are six steps to forecasting collections. The first step is to estimate what collections would have been without recent changes to the law. Combined inheritance and estate tax collections under the law prior to Legislative Referendum 116 are forecast using a statistical forecasting model. Each year's collections are forecast based on the number of deaths, a measure of wealth, per capita income, and previous collections.

The remaining five steps incorporate the effects of recent law changes. The second step is to allocate the forecast of inheritance and estate tax collections between the two taxes. This is necessary because the two taxes are being phased out differently. The third step is to adjust the forecast for increased inheritance tax exemptions enacted by the 1997 and 1999 legislatures. The fourth step is to allocate the fiscal year forecasts to the months within each fiscal year. This is necessary because the tax phase-outs are based on the calendar year when a person dies, not on the fiscal year when the tax is paid. The fifth step is to adjust these projected monthly collections for the phase-outs of the two taxes. The last step is to combine the adjusted monthly projections into final fiscal year projections.

Prior Law Collections

A statistical forecasting model was estimated from information for the period 1982 through 2000. Data after 2000 was not used because more recent collections are affected by the phase-out of the taxes. This model predicts combined inheritance and estate tax receipts using the number of deaths two years earlier, the average value of the Standard and Poor's 500 index of stock prices, personal income per capita, and receipts five years earlier. This model had the best overall statistical performance of a number of models tried and explains 96.7% of the variation in receipts in the period 1982 through 2000.

Table 2 shows details of the model. The middle column shows, for FY 1982 through FY 2000, the average values of receipts, deaths two years earlier, the Standard and Poor's 500 index two years earlier, personal income per capita, and receipts five years earlier.

Table 2		
Inheritance Tax Forecasting Model		
	Average FY1982- FY2000	Model Coefficient
Receipts (\$ million)	\$11.262	
Deaths 2 Years Ago	7,032.8	0.0074
S&P500 2 Years Ago	378.6	-0.0003
Personal Income Per Capita	\$15,973	0.0005
Receipts 5 Years Ago (\$ million)	\$8.684	-0.2409

The coefficients in the right-hand column of Table 2 give the amount that receipts increase or decrease when one of the explanatory factors increases by one. For example, the coefficient of 0.0056 for Standard and Poor's 500 two years earlier means that an increase of 1 in this stock price index would increase collections two years later by \$0.0056 million. An increase of 1,000 would increase collections by \$5.6 million. If the Table 2 model variables--deaths two years ago, personal income per capita, and receipts five years ago-- were all at their average values and the Standard and Poor's 500 index two years earlier was 1,000 above its average, the model predicts that receipts would be \$16.862 million ($\$11.262 + \$5.6 = \16.862).

The inheritance and estate taxes are taxes on transfers of wealth when a person dies. Stock prices and personal income help explain inheritance and estate tax collections because they are correlated with the average size of taxable estates. Deaths and stock prices two years ago explain inheritance and estate tax collections better than current or last year's deaths and stock prices. This is because it takes time to settle most estates. Seventy percent of estates with inheritance or estate tax liability take longer than a year to settle. Inheritance tax receipts grew significantly from FY 1982 to FY 2000 and also showed strong cycles. Including past receipts in the model helps capture those cycles.

Table 3 shows forecasts of deaths two years ago, the Standard and Poor's 500 index two years earlier, personal income per capita and receipts five years ago for FY 2005 through FY 2007. It also shows the resulting forecast of combined inheritance and estate tax collections under prior law. The forecast shows prior-law collections increasing over 6% in FY 2005 and FY 2007 and by almost 4% in FY 2006.

Table 3 Prior Law Inheritance Tax Forecast						
Fiscal Year	Deaths 2 Years Ago	SP500 2 Years Ago	Personal Income Per Capita	Receipts 5 Years Ago (\$ million)	Collections (\$ million)	% Change
2005	8,624	964	\$ 27,849	\$ 19.003	\$ 26.359	6.36%
2006	8,736	1,115	\$ 29,051	\$ 20.593	\$ 27.345	3.74%
2007	8,849	1,140	\$ 30,341	\$ 19.372	\$ 29.095	6.40%

1997 and 1999 Law Changes

Some bequests are exempt from the inheritance tax. Other bequests are taxed at different rates depending on the relationship between the decedent and the heir, and on the size of the bequest. The 1997 and 1999 legislatures made several changes to the law. The 1997 legislature increased the amount of life insurance excluded from inheritance tax from \$50,000 to \$250,000. It made all tangible personal property of a closely held business exempt from inheritance tax if the heirs are lineal

descendents of the decedent's grandparents. It also temporarily changed the law so that bequests to a stepchild are exempt from the tax regardless of the age at which the heir became a stepchild of the decedent. Previously, bequests to a stepchild had been exempt only if the heir had become a stepchild before the age of eighteen. The 1999 legislature made this change permanent.

The Department of Revenue examined individual inheritance tax returns for 1998 through 2000 and estimated the fraction of taxable estates being passed to heirs affected by these law changes. For FY 2002, these law changes are estimated to have reduced inheritance tax liability by \$2.382 million. The impact of these law changes is assumed to grow in proportion to the total value of estates subject to inheritance tax. The model predicts that prior-law tax liability would be 22.1% higher in FY 2005 than in FY 2002, 26.7% higher in FY 2006 and 34.8% higher in FY 2007. This gives estimated reductions of \$2.725 million in FY 2005, \$2.826 million in FY 2006 and \$3.007 million in FY 2007.

Separating Inheritance and Estate Tax

Although they have been treated as one revenue source, the Department of Revenue has kept records identifying individual payments as either inheritance tax or estate tax. These records were examined for returns filed in fiscal years 1999, 2000, and part of 2001. The tax collected with these returns was 61.44% inheritance tax and 38.56% estate tax.

Table 4 shows projected inheritance tax and estate tax collections with adjustments for the changes in state law made by the 1997 and 1999 legislatures.

Table 4 Forecast Inheritance Tax and Estate Tax With 1997 and 1999 State Law Adjustments						
Fiscal Year	Prior-Law Combined Forecast	Inheritance Tax %	Prior Law Inheritance Tax	Estate Tax	1997 and 1999 Law Adjustments	Adjusted Inheritance Tax
2005	\$26.359	61.44%	\$16.195	\$10.164	-\$2.725	\$13.470
2006	\$27.345	61.44%	\$16.801	\$10.544	-\$2.826	\$13.974
2007	\$29.095	61.44%	\$17.876	\$11.219	-\$3.007	\$14.869

The second column shows the forecast of collections produced by the statistical model. The third column shows the percentage of the combined forecast that is inheritance tax. The fourth column shows projected prior law inheritance tax collections, which equal the combined forecast in the second column multiplied by the percentage in the third column. The fifth column shows projected estate tax collections, which equal the combined forecast in the second column less prior law

inheritance tax in the fourth column. The sixth column shows amounts that must be subtracted from projected inheritance tax because of the 1997 and 1999 law changes. The seventh column shows the adjusted forecast of inheritance tax.

Monthly Collections

Inheritance and estate tax collections are not steady throughout the year. They tend to be highest in October and June and lowest in December and March. Table 5 shows projected receipts for FY 2005 through FY 2007 distributed across months. The first column lists the months in a fiscal year, and the second column shows the average fraction of annual receipts in each month in FY 1994 through FY 2001. The third through fifth columns show projected inheritance tax collections for FY 2005 through FY 2007 distributed across months in these proportions. The sixth through eighth columns show projected estate tax collections distributed in the same way.

Table 5 Monthly Inheritance Tax and Estate Tax Collections Adjusted for 1997 and 1999 State Law Changes							
Month	% of Collec- tions	Inheritance Tax			Estate Tax		
		FY 2005	FY 2006	FY2007	FY 2005	FY 2006	FY2007
July	7.30%	\$0.984	\$1.021	\$1.086	\$0.742	\$0.770	\$0.819
August	9.10%	\$1.226	\$1.272	\$1.353	\$0.925	\$0.959	\$1.021
September	7.13%	\$0.960	\$0.996	\$1.060	\$0.725	\$0.752	\$0.800
October	12.57%	\$1.693	\$1.757	\$1.869	\$1.278	\$1.325	\$1.410
November	7.69%	\$1.037	\$1.075	\$1.144	\$0.782	\$0.811	\$0.863
December	5.57%	\$0.750	\$0.778	\$0.827	\$0.566	\$0.587	\$0.624
January	8.45%	\$1.138	\$1.180	\$1.256	\$0.859	\$0.891	\$0.948
February	7.87%	\$1.060	\$1.099	\$1.170	\$0.800	\$0.830	\$0.883
March	6.61%	\$0.890	\$0.924	\$0.983	\$0.672	\$0.697	\$0.741
April	8.75%	\$1.179	\$1.223	\$1.302	\$0.890	\$0.923	\$0.982
May	8.32%	\$1.120	\$1.162	\$1.237	\$0.845	\$0.877	\$0.933
June	10.64%	\$1.434	\$1.487	\$1.582	\$1.082	\$1.122	\$1.194
Total	100.00%	\$13.470	\$13.974	\$14.869	\$10.164	\$10.544	\$11.219

Phase-Out of Taxes

Legislative Referendum 116 repealed the inheritance tax. The tax does not apply to the estates of persons dying after December 31, 2000.

The Montana estate tax is equal to the maximum credit for state taxes allowed against federal estate taxes. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 phases out the federal estate tax and eliminates it for the

estates of persons dying after December 31, 2009. It reduces the credit for state taxes on a faster schedule, eliminating it for the estates of persons dying after December 31, 2004.

The maximum credit for state taxes is calculated from a schedule that depends on the net taxable estate. The 2001 federal tax act leaves the schedule unchanged, but sets the maximum credit at 75% of the amount from the schedule for deaths in 2002, 50% for deaths in 2003, and 25% for deaths in 2004.

The 2001 federal tax act also increases the amount of each estate that is exempt from federal estate tax. For each estate, this reduces the net taxable estate, which reduces the maximum state credit. The exemption currently is \$675,000 for deaths before 2002. Under previous federal law, the exemption was \$700,000 for deaths in 2002 and 2003 and \$850,000 for deaths in 2004. The new law increased the exemption to \$1 million for deaths in 2002 and 2003, and to \$1.5 million for deaths in 2004.

Together, these changes in federal law will reduce estate tax liability by 43% for deaths in 2002, 62% for deaths in 2003, and 86.5% for deaths in 2004.

However, it takes time to settle most estates. Some pre-2001 estates will continue to be settled and pay inheritance tax each year for at least the next ten years. Most estates paying estate tax in any year will be from previous years. Thus, inheritance and estate tax collections will decline over a period of several years.

The time between death and settling of the estate was calculated for inheritance and estate tax records from FY 1999, FY 2000, and the first quarter of FY 2001. Approximately half of returns paying inheritance tax were filed within 12 months of death. Seventy percent were filed within 18 months, and 85% within 36 months. Fewer estates paying estate tax are settled quickly. Only 6% were filed in less than nine months, and 34% were filed within 12 months. Seventy-five percent were filed within 18 months, and 92% within 36 months.

As the inheritance and estate taxes are phased out, the tax collected each month will be a percentage of the tax that would have been collected under prior law. For the inheritance tax, this is the percentage of estates where death was before January 1, 2001.

For the estate tax, estates where death was before January 1, 2002 will pay the same tax as under prior law. Estates where death was in calendar year 2002 will pay 43% less tax than under prior law. Estates where death was in calendar year 2003 will pay 62% less tax than under prior law. Estates where death is in calendar year 2004 will pay 86.5% less than under current law.

Thus, estate tax collections in any month will be the following percentage of prior law collections: the percentage of estates where death was before 2002 plus 57% (100% - 43%) times the percentage of estates where death was in 2002 plus 38%

times the percentage of estates where death was in 2003 plus 13.5% times the percentage of estates where death was in 2004.

Table 6 shows the projected year of death for estates settled in FY 2005 through FY 2007. The first two columns show the fiscal year and month. The third column shows the percentage of estates that would owe inheritance tax under prior law where death was before January 1, 2001. Of estates settled in July 2005 that would owe inheritance tax under prior law, 11.76% are projected to be for deaths before January 2001. This percentage is projected to decline every month and be 5.72% in June 2007.

Table 6 Year of Death for Estates Settled in Fiscal Years 2005 through 2007 Percent of Value of Estates Taxable under Prior Law						
Month Estate Settled		Inheritance Tax	Estate Tax			
Fiscal Year	Month	Death Before 2001	Death Before 2002	Death in 2002	Death in 2003	Death in 2004
2005	July	11.76%	11.53%	14.12%	71.29%	3.06%
	August	11.34%	10.12%	11.76%	73.88%	4.24%
	September	10.93%	9.41%	10.82%	73.41%	6.35%
	October	10.61%	9.41%	9.65%	62.35%	18.59%
	November	10.40%	8.94%	8.94%	56.71%	25.41%
	December	10.09%	8.71%	7.76%	53.18%	30.35%
	January	9.80%	8.24%	7.29%	50.82%	33.65%
	February	9.59%	7.76%	6.59%	48.71%	36.94%
	March	9.44%	7.53%	6.59%	44.71%	41.18%
	April	9.15%	7.06%	6.35%	41.41%	44.71%
	May	8.98%	7.06%	5.65%	38.35%	47.76%
	June	8.84%	7.06%	4.47%	31.29%	54.35%
2006	July	8.69%	6.82%	4.71%	14.12%	71.29%
	August	8.50%	6.12%	4.00%	11.76%	73.88%
	September	8.36%	6.12%	3.29%	10.82%	73.41%
	October	8.21%	5.88%	3.53%	9.65%	62.35%
	November	8.02%	5.41%	3.53%	8.94%	56.71%
	December	7.92%	4.47%	4.24%	7.76%	53.18%
	January	7.85%	4.00%	4.24%	7.29%	50.82%
	February	7.65%	3.76%	4.00%	6.59%	48.71%
	March	7.52%	3.53%	4.00%	6.59%	44.71%
	April	7.37%	3.53%	3.53%	6.35%	41.41%
	May	7.27%	3.29%	3.76%	5.65%	38.35%
	June	7.08%	3.29%	3.76%	4.47%	31.29%
2007	July	6.98%	3.29%	3.53%	4.71%	14.12%
	August	6.79%	3.29%	2.82%	4.00%	11.76%
	September	6.64%	3.29%	2.82%	3.29%	10.82%
	October	6.45%	3.29%	2.59%	3.53%	9.65%
	November	6.39%	3.29%	2.12%	3.53%	8.94%
	December	6.27%	2.82%	1.65%	4.24%	7.76%
	January	6.14%	2.59%	1.18%	4.00%	6.59%
	February	6.10%	2.59%	0.94%	4.00%	6.59%
	March	5.97%	2.59%	0.94%	3.53%	6.35%
	April	5.91%	2.59%	0.71%	3.76%	5.65%
	May	5.79%	2.59%	0.71%	3.76%	4.47%
	June	5.72%	2.59%	0.71%	3.53%	4.71%

The four right-hand columns show the projected distribution of year of death for estates that would owe estate tax under prior law. The fourth column shows the percentage of these estates where death was before January 1, 2002. The fifth column shows the percentage where death was in 2002, the sixth column shows the percentage where death was in 2003, and the seventh column shows the percentage where death was in 2004.

The percentage of deaths before 2002 is 11.53% in July 2005 and declines every month. It is 2.59% in June 2007. The percentage of deaths in 2002 is 14.12% in July 2005. It decreases every month and is 0.71% in June 2007. The percentage where death is in 2003 is 71.29% in July 2005 and declines every month to 3.53% in June 2007. The percentage where death was in 2004 is 3.06% in July 2005. It increases to 73.88% in August 2006 and then declines to 4.71% in June 2007.

The percentages in the four right-hand columns of the table sum to 100% through March 2005. Beginning in April 2005, these columns sum to less than 100% because a percentage of deaths are projected to be in 2005 and later years. Since these estates will pay no tax, these percentages are not shown.

Table 7, on the following page, shows, for each month in FY 2005 through FY 2007, projected current law inheritance and estate tax collections as a percentage of projected prior law collections.

The first two columns show the fiscal year and the month. The third column shows current law inheritance tax collections as a percentage of prior law collections. This equals the percentage of pre-2001 estates shown in the third column of Table 6.

The fourth column shows current law taxes from pre-2002 estates as a percentage of total prior law taxes. It is the percentage of estates where death was before 2002, shown in the fourth column of Table 6. The fifth through seventh columns show taxes from estates settled in 2002 through 2004 as a percentage of total prior law taxes. In each column, this is the percentage of estates with deaths in that year, shown in the fifth through seventh columns of Table 6, multiplied by the percentage of prior law tax due for deaths in each year. Thus, the percentages in the fifth column equal the percentage of estates with 2002 deaths, shown in the fifth column of Table 7, multiplied by 57%. The sixth column shows the percentage of estates with 2003 deaths multiplied by 38%. The seventh column shows the percentage of estates with 2004 deaths multiplied by 13.5%.

For the first month of FY 2005, current law inheritance tax collections are projected to be 11.8% of prior law collections, and current law estate tax collections are projected to be 47.1% of prior law collections. Inheritance tax collections are projected to decrease to 5.7% of prior law collections by the last month of FY 2007. Estate tax collections are projected to decline to 5.0% of prior law collections by the last month of FY 2007.

Table 7
Current Law Inheritance and Estate Tax Liability
Percentage of Prior Law Liability

Fiscal Year	Month	Inheritance Tax	Estate Tax				Total
			Pre-2002 Deaths No Reduction	2002 Deaths 43% Reduction	2003 Deaths 62% Reduction	2004 Deaths 86% Reduction	
2005	July	11.8%	11.5%	8.0%	27.1%	0.4%	47.1%
	August	11.3%	10.1%	6.7%	28.1%	0.6%	45.4%
	September	10.9%	9.4%	6.2%	27.9%	0.9%	44.3%
	October	10.6%	9.4%	5.5%	23.7%	2.5%	41.1%
	November	10.4%	8.9%	5.1%	21.5%	3.4%	39.0%
	December	10.1%	8.7%	4.4%	20.2%	4.1%	37.4%
	January	9.8%	8.2%	4.2%	19.3%	4.5%	36.2%
	February	9.6%	7.8%	3.8%	18.5%	5.0%	35.0%
	March	9.4%	7.5%	3.8%	17.0%	5.6%	33.8%
	April	9.2%	7.1%	3.6%	15.7%	6.0%	32.4%
	May	9.0%	7.1%	3.2%	14.6%	6.5%	31.3%
	June	8.8%	7.1%	2.5%	11.9%	7.3%	28.8%
2006	July	8.7%	6.8%	2.7%	5.4%	9.6%	14.9%
	August	8.5%	6.1%	2.3%	4.5%	10.0%	12.9%
	September	8.4%	6.1%	1.9%	4.1%	9.9%	12.1%
	October	8.2%	5.9%	2.0%	3.7%	8.4%	11.6%
	November	8.0%	5.4%	2.0%	3.4%	7.7%	10.8%
	December	7.9%	4.5%	2.4%	2.9%	7.2%	9.8%
	January	7.8%	4.0%	2.4%	2.8%	6.9%	9.2%
	February	7.7%	3.8%	2.3%	2.5%	6.6%	8.5%
	March	7.5%	3.5%	2.3%	2.5%	6.0%	8.3%
	April	7.4%	3.5%	2.0%	2.4%	5.6%	13.5%
	May	7.3%	3.3%	2.1%	2.1%	5.2%	12.8%
	June	7.1%	3.3%	2.1%	1.7%	4.2%	11.4%
2007	July	7.0%	3.3%	2.0%	1.8%	1.9%	9.0%
	August	6.8%	3.3%	1.6%	1.5%	1.6%	8.0%
	September	6.6%	3.3%	1.6%	1.3%	1.5%	7.6%
	October	6.4%	3.3%	1.5%	1.3%	1.3%	7.4%
	November	6.4%	3.3%	1.2%	1.3%	1.2%	7.0%
	December	6.3%	2.8%	0.9%	1.6%	1.0%	6.4%
	January	6.1%	2.6%	0.7%	1.5%	0.9%	5.7%
	February	6.1%	2.6%	0.5%	1.5%	0.9%	5.5%
	March	6.0%	2.6%	0.5%	1.3%	0.9%	5.3%
	April	5.9%	2.6%	0.4%	1.4%	0.8%	5.2%
	May	5.8%	2.6%	0.4%	1.4%	0.6%	5.0%
	June	5.7%	2.6%	0.4%	1.3%	0.6%	5.0%

Table 8 shows the calculation of projected current law inheritance and estate tax collections.

Table 8							
Monthly Current Law Inheritance and Estate Tax Collections							
Fiscal Year	Month	Inheritance Tax			Estate Tax		
		Prior Law Tax	Current Law %	Current Law Tax	Prior Law Tax	Current Law %	Current Law Tax
2005	July	\$0.984	11.8%	\$0.116	\$0.742	47.1%	\$0.349
	August	\$1.226	11.3%	\$0.139	\$0.925	45.4%	\$0.420
	September	\$0.960	10.9%	\$0.105	\$0.725	44.3%	\$0.321
	October	\$1.693	10.6%	\$0.180	\$1.278	41.1%	\$0.525
	November	\$1.037	10.4%	\$0.108	\$0.782	39.0%	\$0.305
	December	\$0.750	10.1%	\$0.076	\$0.566	37.4%	\$0.212
	January	\$1.138	9.8%	\$0.112	\$0.859	36.2%	\$0.311
	February	\$1.060	9.6%	\$0.102	\$0.800	35.0%	\$0.280
	March	\$0.890	9.4%	\$0.084	\$0.672	33.8%	\$0.227
	April	\$1.179	9.2%	\$0.108	\$0.890	32.4%	\$0.289
	May	\$1.120	9.0%	\$0.101	\$0.845	31.3%	\$0.265
	June	\$1.434	8.8%	\$0.127	\$1.082	28.8%	\$0.312
	TOTAL	\$13.470	10.1%	\$1.355	\$10.164	37.5%	\$3.815
2006	July	\$1.021	8.7%	\$0.089	\$0.770	14.9%	\$0.114
	August	\$1.272	8.5%	\$0.108	\$0.959	12.9%	\$0.123
	September	\$0.996	8.4%	\$0.083	\$0.752	12.1%	\$0.091
	October	\$1.757	8.2%	\$0.144	\$1.325	11.6%	\$0.153
	November	\$1.075	8.0%	\$0.086	\$0.811	10.8%	\$0.088
	December	\$0.778	7.9%	\$0.062	\$0.587	9.8%	\$0.058
	January	\$1.180	7.8%	\$0.093	\$0.891	9.2%	\$0.082
	February	\$1.099	7.7%	\$0.084	\$0.830	8.5%	\$0.071
	March	\$0.924	7.5%	\$0.069	\$0.697	8.3%	\$0.058
	April	\$1.223	7.4%	\$0.090	\$0.923	13.5%	\$0.125
	May	\$1.162	7.3%	\$0.085	\$0.877	12.8%	\$0.112
	June	\$1.487	7.1%	\$0.105	\$1.122	11.4%	\$0.128
	TOTAL	\$13.974	7.9%	\$1.098	\$10.544	11.4%	\$1.203
2007	July	\$1.086	7.0%	\$0.076	\$0.819	9.0%	\$0.074
	August	\$1.353	6.8%	\$0.092	\$1.021	8.0%	\$0.082
	September	\$1.060	6.6%	\$0.070	\$0.800	7.6%	\$0.061
	October	\$1.869	6.4%	\$0.120	\$1.410	7.4%	\$0.105
	November	\$1.144	6.4%	\$0.073	\$0.863	7.0%	\$0.061
	December	\$0.827	6.3%	\$0.052	\$0.624	6.4%	\$0.040
	January	\$1.256	6.1%	\$0.077	\$0.948	5.7%	\$0.054
	February	\$1.170	6.1%	\$0.071	\$0.883	5.5%	\$0.049
	March	\$0.983	6.0%	\$0.059	\$0.741	5.3%	\$0.039
	April	\$1.302	5.9%	\$0.077	\$0.982	5.2%	\$0.051
	May	\$1.237	5.8%	\$0.072	\$0.933	5.0%	\$0.047
	June	\$1.582	5.7%	\$0.090	\$1.194	5.0%	\$0.059
	TOTAL	\$14.869	6.3%	\$0.930	\$11.219	6.4%	\$0.721

For each month, the third column shows prior law inheritance tax from Table 4, and the sixth column shows prior law estate tax from Table 4. The fourth and seventh columns show current collections as a percentage of prior law collections from Table 7. The fifth and eighth columns show current law collections, which equal prior law collections in the third and sixth columns multiplied by the percentages in the fourth and seventh columns.

Inheritance tax collections are projected to be \$1.355 million in FY 2005, \$1.098 million in FY 2006 and \$0.930 million in FY 2007. Estate tax collections are projected to be \$3.815 million in FY 2005, \$1.203 million in FY 2006 and \$0.721 million in FY 2007. Total collections are projected to be \$5.171 million in FY 2005, \$2.301 million in FY 2006 and \$1.651 million in FY 2007.

Forecast Risks

As the inheritance and estate taxes are phased out, collections will become more variable because variations in taxes paid by individual estates will become relatively more significant. Only a few large estates are settled each year and some of them pay little or no tax. This is because bequests to the decedent's spouse are exempt, and bequests to close relatives are taxed at reduced rates. From 1994 through 2003, there were an average of seven estates with an inflation-adjusted value of \$5 million or more per year. On average, these estates paid inheritance and estate taxes equal to 1.8% of the value of the estate, and tax paid by these estates was 10% of the total. Thirty-six percent of these estates paid no tax. As the number of estates filing decreases each year, it becomes more likely that the tax paid by large estates will differ significantly from the average. With seven large estates filing in a year, there is about a 5% probability that either all or none of them will pay taxes. With two large estates filing a year, there is over a 50% probability that either all or none of them will pay taxes.

Collections in FY 2004 were about \$4 million or 55% higher than predicted because five large estates paid an average of over \$1 million each. Based on the experience of previous years, one estate paying tax of \$1 million or more was expected. The variation in future years is unlikely to be this large, but is still likely to be larger in relative terms than in the past.

GENERAL FUND OTHER REVENUE

Revenue Description

Other revenue represents all of the sources of general fund revenue that do not have an individual line item in the revenue estimating resolution. The individual items included in other revenue generally have general fund revenue of \$2 million or less. Some of them may have one-time revenue of more than \$2 million. In FY 2004, there were 46 items of general fund revenue included in other revenue.

Historical and Projected Revenue

Table 1 shows past and projected collections from other general fund revenue sources.

Fiscal Year	Other Revenue	FEMA	General Fund	Percent Change
A 1994	\$13.714	\$0.189	\$13.903	-22.74%
A 1995	\$16.565	\$3.652	\$20.217	45.41%
A 1996	\$14.868	\$0.263	\$15.131	-25.16%
A 1997	\$14.275	\$2.814	\$17.089	12.94%
A 1998	\$25.694	\$0.219	\$25.913	51.64%
A 1999	\$32.323	\$1.801	\$34.124	31.69%
A 2000	\$19.180	\$1.015	\$20.195	-40.82%
A 2001	\$27.448	\$24.388	\$51.836	156.68%
A 2002	\$25.874	\$16.564	\$42.438	-18.13%
A 2003	\$25.895	\$0.000	\$25.895	-38.98%
A 2004	\$29.432	\$0.000	\$29.432	13.66%
F 2005	\$27.592	\$0.200	\$27.792	-5.57%
F 2006	\$23.389	\$0.200	\$23.589	-15.12%
F 2007	\$23.434	\$0.200	\$23.634	0.19%

Fiscal Year	Other Revenue (\$ millions)	FEMA (\$ millions)
1994	13.714	0.189
1995	16.565	3.652
1996	14.868	0.263
1997	14.275	2.814
1998	25.694	0.219
1999	32.323	1.801
2000	19.180	1.015
2001	27.448	24.388
2002	25.874	16.564
2003	25.895	0.000
2004	29.432	0.000
2005	27.592	0.200
2006	23.389	0.200
2007	23.434	0.200

Other revenue includes reimbursements from the Federal Emergency Management Agency (FEMA). These reimbursements are shown separately in Table 1 because FEMA reimbursements for the costs of fighting forest fires were much higher than normal in FY 2001 and FY 2002. The non-FEMA component of other revenue was \$3.5 million higher in FY 2004 than in FY 2003, primarily because of settlements of enforcement actions by the State Auditor's Office. Other revenue is projected to be higher than normal in FY 2005 because of one-time transfers from other funds enacted by the legislature in the 2002 special session and the 2003 regular session. Most other components of this revenue source are forecast to be stable through FY 2007, and non-FEMA revenue is projected to be \$23.4 million in both FY 2006 and FY 2007.

Forecast Methodology and Projection Calculation

The forecast for general fund collections from other revenue sources is done in two steps. Twenty-eight items are examined individually. The remaining 18 items, which comprised a total of \$97,926 in FY 2003, are forecast as a group.

Individually Forecast Items

Twenty-eight items were examined in some detail to obtain a forecast of revenue from each item separately. The forecasts for these items were then summed to get total revenue for the group.

The first step in examining each item was to account for one-time events and changes in the law. Next, the history was examined to determine whether there was a trend or other pattern in receipts. Where receipts have been stable or growing steadily, the forecast was based on this past trend. For about half of the items, variations in past receipts or recent law changes made a trend forecast inappropriate. In some of these cases, revenues through FY 2007 are forecast to be the same as revenues in FY 2004. In other cases, the forecast was based on discussions of future revenues with agency staff.

Vehicle Licenses and Permits, Attorney Licenses, and Emergency Telephone system Fee showed consistent growth and are forecast to continue to grow at the same rate each fiscal year.

Eleven items show no trend in collections, and the forecast is the average of recent years' revenues. These items are *Miscellaneous Receipts, Cement Tax, Securities and Insurance Fines, Civil Penalty Fines, Federal Indirect Cost Recovery, Miscellaneous Federal Assistance, Attorney License, Documents Sold, Proceeds of Fixed Asset Distribution, Administrative Fees, and Inception of Installment Purchase Contracts*. One-time receipts in FY 2004 were removed from *Miscellaneous Receipts* and *Securities and Insurance Fines* before averaging receipts from the last four years. *Documents Sold, Proceeds of Fixed Asset Distribution, and Inception of Installment Purchase Contract* were averaged over three years to remove one-time revenue from the average. *Administrative Fees* more than doubled in FY 2003 because district court fees that formerly were retained by counties began going to the general fund, so it was averaged over the last two years. The 2002 legislature allocated \$1.7 million of *Accommodations Tax* revenue to the general fund. This was removed before averaging the last four years' general fund reimbursements for accommodations tax on state employee's business travel. The other items were averaged over the last four years.

Health licenses and permits follow a regular pattern because of the renewal of multi-year hospital and nursing home licenses. Revenue in odd numbered fiscal years is forecast to equal the average of revenue in the last two odd numbered fiscal years.

Revenue in even numbered fiscal years is forecast to equal the average of revenue in the last two even numbered fiscal years.

Eleven items are affected by recent legislation or other changes.

Transfers in General consists of transfers from other funds to the general fund. It includes earnings on the State Auditor's Office's portfolio of regulated securities, which are fairly consistent over time. It also includes transfers of year-end balances from special revenue funds and one-time transfers. Three changes from FY 2004 revenue are expected in FY 2005 through FY 2007. Cigarette tax allocated to the state veteran's home in excess of appropriations is transferred to the general fund. Because of declining cigarette sales, this amount is expected to decrease by \$0.145 million in FY 2005, by \$0.120 million in FY 2006, and by \$0.081 million in FY 2007. SB 493 (2003 session) authorizes the transfer of up to \$3.7 million from the motor vehicle information technology fund to the general fund in the 2005 biennium. It is expected that the balance available for transfer at the end of FY 2005 will be \$3.3 million. It is expected that an unappropriated balance of \$0.456 million in the coal tax local impacts account will revert to the general fund at the end of FY 2005. The forecast for each year equals FY 2004 collections adjusted for these changes.

SWCAP - Indirect Cost Recovery is agency payments for centralized services, such as debt service for the state accounting system, through the Statewide Cost Allocation Plan. Through FY 2004, statewide capital costs were recovered through the separate *State Funds Cap Recovery*. Beginning in FY 2005, all costs are recovered through a single SWCAP charge. The Department of Administration has estimated charges through FY 2007. In the 2005 biennium, the Department of Administration temporarily lowered its charges to agencies for debt service for the state accounting system. Total payments in FY 2005 are expected to be \$0.236 million lower than in FY 2004. Payments in FY 2006 and FY 2007 are scheduled to be \$0.755 million higher.

Liquor License Transfers formerly were deposited directly in the general fund, but beginning in FY 2002 they are retained in the Department of Revenue's liquor enterprise fund until the end of the fiscal year. The legislature makes several appropriations from these funds. At the end of the year, the department transfers the difference between revenue and appropriations to the general fund. Appropriations were larger than normal in FY 2003. Net revenue to the general fund is projected to remain at the FY 2004 level.

Miscellaneous Service Fees includes fees for driver's license reinstatements that were changed by HB 195, HB 215 and HB 478 passed by the 2003 legislature. SB 26 (2003 session) moved title company fees from the general fund to a state special revenue fund. The net effect of these bills increased revenue in FY 2004 and is expected to increase revenue by an additional \$0.846 million in FY 2005. Revenue each year through FY 2007 is projected to be \$0.846 million more than revenue in FY 2004.

Before FY 2003, *Miscellaneous Cost Recovery* consisted primarily of payments to the Department of Natural Resources and Conservation (DNRC) for state costs of fighting fires on federal land. Beginning In FY 2003, these reimbursements flow through a federal special revenue account rather than through the general fund. The forecast is for collections to be steady at the FY 2004 level.

Prior to HB 124 (2001 session) clerk of court fees were divided between the state and the counties where they were collected. The state's share made up the bulk of *Filing Fees*. HB 124 brought most revenue collected by clerks of courts to the state. This larger revenue stream is now included in the administrative fees category. In FY 2004, the only revenue remaining in this category was adoption fees. They are projected to remain at the FY 2004 level through FY 2007.

Miscellaneous Fines and Forfeitures increased significantly in FY 2003 due to legislative and administrative changes. This revenue source consists primarily of fines levied for specific violations and can vary from year to year. A one-time payment of \$1.0 million has been received early in FY 2005. Revenue for FY 2005 is projected to be \$1.0 million more than revenue in FY 2004. Revenue in FY 2006 and FY 2007 is projected to equal revenue in FY 2004.

Through FY 2003, fees collected at the state law enforcement academy went to the general fund and were included in *Student Tuition and Fees*. Beginning in FY 2004, these fees go to a state special revenue fund. This reduced general fund revenue by \$0.1 million. Revenue is projected to be stable at the FY 2004 level.

The 2003 legislature created a new food manufacturers license and moved apiary license and background check fees from the general fund to special revenue funds. These changes reduced *Inspection and Testing Fees* beginning in FY 2004. The forecast is for fees to remain at the FY 2004 level.

Rentals and PSC Licenses and Permits were slightly lower in FY 2004 than in previous years. They are forecast to be the same as in FY 2004.

Table 2 shows revenue from items forecast individually.

Table 2
Other Revenue - Items Estimated Individually

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
Transfers - In General	\$ 3,516,118	\$ 7,102,300	\$ 5,362,186	\$ 4,448,393	\$ 8,149,150	\$ 4,182,658	\$ 4,101,684
SWCAP - IDC Recovery	2,947,572	2,977,342	2,755,212	1,318,788	1,082,172	1,836,574	1,836,574
Administrative Fees	2,374,200	2,451,139	5,493,374	5,449,170	5,471,272	5,471,272	5,471,272
Escheated Revenue	2,287,839	1,624,861	2,373,192	3,182,790	3,278,274	3,376,622	3,477,921
Liquor License Transfers	1,789,706	1,036,184	558,198	734,102	734,102	734,102	734,102
Miscellaneous Service Fee	1,764,977	1,837,689	2,403,893	2,511,944	3,358,064	3,358,064	3,358,064
Vehicle Licenses & Permits	1,278,684	1,298,046	1,236,831	1,264,401	1,269,491	1,269,491	1,269,491
Misc. Cost Recovery	6,921,527	3,882,961	232,830	264,196	264,196	264,196	264,196
State Funds Cap Recovery (SFCAP)	582,728	629,046	661,224	898,870	-	-	-
Miscellaneous Receipts	562,283	446,756	430,082	1,164,729	425,186	425,186	425,186
Filing Fee	340,508	363,436	-	39,015	39,015	39,015	39,015
Documents Sold	849,743	289,426	325,714	310,699	308,613	308,613	308,613
Misc. Fines/Forfeitures	262,898	253,167	675,365	532,059	1,601,042	532,059	532,059
Misc. Fed Assistance	200,337	195,597	-	395,290	197,806	197,806	197,806
Student Tuition and Fees	152,071	165,892	159,125	51,035	51,035	51,035	51,035
Emergency Telephone System Fee	155,280	185,825	201,340	201,526	203,541	205,576	207,632
Inspection/Testing Fee	175,549	206,029	304,205	32,397	32,397	32,397	32,397
Cement Tax	136,301	163,893	145,126	132,604	144,481	144,481	144,481
Securities/Insurance Fines	135,698	139,459	143,256	5,100,914	159,537	159,537	159,537
Attorney License	95,000	98,130	96,650	97,750	96,883	96,883	96,883
Civil Penalty Fines	86,143	328,159	46,081	172,479	157,515	157,515	157,515
Health Licenses and Permits	52,127	64,085	53,686	72,167	52,907	68,126	52,907
Federal Indirect Cost Recovery	88,855	93,584	126,172	156,139	116,187	116,187	116,187
Proceeds of Fixed Asset Distribution	125,047	81,556	60,536	93,264	78,452	78,452	78,452
Rentals	32,567	33,715	28,267	32,986	32,986	32,986	32,986
Accommodations Tax	52,215	38,912	1,732,547	40,021	40,924	40,924	40,924
PSC Licenses & Permits	5,015	5,375	5,460	4,680	4,680	4,680	4,680
Incept. of Inst. Purch. Cont	9,587	53,694	160,214	631,735	74,498	74,498	74,498
Subtotal	\$ 26,980,575	\$ 26,046,259	\$ 25,770,763	\$ 29,334,141	\$ 27,424,404	\$ 23,258,934	\$ 23,266,095

Revenue Sources Estimated as a Group

As discussed above, 18 separate items are estimated as a group. Table 3 shows total collections from this group in FY 1997 through FY 2003 and projected collections through FY 2007.

Collections in FY 1997 through FY 1998 and FY 2000 and FY 2001 show a moderate amount of variability but no clear trend. Collections in FY 1999 were much higher, primarily because of one-time receipts. For the revenue sources which continue for FY 2005 and beyond, all but two of the items, estimated as a group, are projected to continue at the average of their levels in FY 2000 through FY 2004 after removing one-time receipts. Lobbyist permits have been about \$40,000 in odd numbered fiscal years and less than \$1,000 in even numbered fiscal years. This pattern is forecast to continue. HB 63 (2003 session) moved apiary fees from the general fund to a special revenue fund. This will reduce general fund revenue by about \$0.017 million.

Table 3
Collections from Sources
Estimated as a Group

<u>Fiscal Year</u>	<u>Total Collections</u>	<u>% Change</u>
A 1997	\$ 331,064	16.44%
A 1998	\$ 262,497	-20.71%
A 1999	\$1,161,960	342.66%
A 2000	\$ 451,554	-61.14%
A 2001	\$ 307,081	-31.99%
A 2002	\$ 275,107	-10.41%
A 2003	\$ 124,259	-54.83%
A 2004	\$ 97,926	-21.19%
F 2005	\$ 167,506	71.05%
F 2006	\$ 130,206	-22.27%
F 2007	\$ 167,506	28.65%

Total Other Revenue

Total non-FEMA other revenue is the sum of the items estimated individually and the items estimated as a group, as shown in Table 4.

Table 4
Total Other Revenue
(\$ millions)

<u>Component of Estimate</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Items Estimated Individually	\$27.424	\$23.259	\$23.266
Items Estimated As a Group	0.168	0.130	0.168
Total Other Revenue	<u>\$27.592</u>	<u>\$23.389</u>	<u>\$23.434</u>

FEMA Reimbursements

Federal reimbursements to the state for forest fire costs were slightly more than \$1 million in FY 2000. Costs from fires in the summer of 2000 were reimbursed during FY 2001 and FY 2002. Reimbursements totaled \$24.388 million in FY 2001 and \$16.564 million in FY 2002. No FEMA reimbursements went to the general fund in FY 2003 and FY 2004.

The forecast assumes light fire seasons with reimbursements of \$0.2 million in each of FY 2005 through FY 2007. Heavier fire seasons would lead to higher firefighting costs, which would be covered by supplemental appropriations and higher reimbursements.



GOVERNOR
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STATE OF MONTANA

NON-GENERAL FUND REVENUE ESTIMATES

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GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Non-General Fund Revenue Estimates

The table on the following page shows non-general fund revenue estimates, by fund for the tax types listed below. For further information on how the numbers are derived, see the applicable revenue estimate write-up.

- Property Tax
- Beer Tax
- Cigarette Tax
- Coal Severance Tax
- Driver's License Fee
- Health Care Facility Fees
- Liquor Excise Tax
- Lodging Facility Use Tax
- Metal Mines Tax
- Oil and Gas Production Tax
- Resource Indemnity Tax
- Resource Indemnity Trust Interest
- Tobacco Settlement Funds
- Tobacco Tax
- Wine Tax

Some non-general fund estimates have individual write-ups in this section of the report. These non-general fund revenue estimates are as follows:

- School Interest and Income
- State Land Trusts Interest and Income
- Tobacco Settlement Trust Interest
- Treasure State Endowment Fund Interest
- Treasure State Endowment Regional Water System Fund Interest
- Resource Indemnity Tax
- Resource Indemnity Trust Interest

Non-General Fund Revenue Estimates - FY 2005 through FY 2007

Revenue Source	FY05	FY06	FY07	Revenue Source	FY05	FY06	FY07
Property Tax				Liquor Excise Tax			
University 6-Mill Account (Property)	11.438	11.667	11.941	DPHHS (65.5%) Alcohol Treatment & Rehab.	3.804	3.929	4.059
				Tribal Allocations	0.186	0.192	0.198
Tobacco Settlement Funds				Metal Mines Tax			
Tobacco Trust Fund (40%)	10.574	8.612	8.505	Hard Rock Mining Impact Trust Account	0.227	0.246	0.258
Tobacco Prevention Acct. (32%)	8.459	6.890	6.804	Hard Rock Mining Reclamation Debt Service Fund	0.770	0.835	0.876
-- Tobacco Prevention Acct.				Reclamation and Development Grants Account	0.634	0.687	0.721
-- Prevention & Stabilization				Local Impact Account	2.175	2.357	2.473
Health Ins. Benefits Acct. (CHIP)(17%)	4.494	3.660	3.615				
Coal Severance Tax				Oil and Gas Production Tax			
Permanent Trust Fund	4.222	3.941	3.908	Board of Oil and Gas Conservation	3.911	3.944	3.993
Treasure State Endowment	8.444	7.881	7.817	County and School Distribution	66.719	66.978	67.756
Regional Water Fund	4.222	3.941	3.908	Coal Bed Methane Protection Account	0.795	0.798	0.807
Long Range Building Program	4.053	3.783	3.752	Reclamation and Development Grants Account	1.906	1.913	1.935
Coal Tax Shared SSR - Local Impacts	2.618	2.443	2.423	Orphan Share Account	1.906	1.913	1.935
Parks Trust	0.429	0.400	0.397	University System 6 - Mill Account (Oil/Gas)	1.712	1.718	1.738
Renewable Resource Debt Service (GO bonds)	0.321	0.299	0.297				
Capitol Art Trust (Cultural Trust)	0.213	0.199	0.197	Health Care Facility Fees			
				Nursing Facility Utilization Fee Account	4.919	4.819	4.722
Resource Indemnity Tax				Prevention & Stabilization Account	0.594	0.625	0.623
CERCLA Match Debt Service	0.000	0.160	0.320				
Groundwater Assessment	0.366	0.366	0.366	Driver's License Fee			
Reclamation and Development Grants Account	0.428	0.320	0.265	Highway Patrol Retirement (22.3% of Driver's license and 25% duplicate)	0.886	0.951	0.905
Natural Resource Workers Scholarship Account	0.150	0.150	0.000	Traffic Education (20.7% of driver's license and 8.75% of duplicate)	0.799	0.858	0.816
Orphan Share Account	0.278	0.170	0.265	Motorcycle Safety Training (63.46%-motorcycle endorsement fee)	0.027	0.029	0.027
Resource Indemnity Trust Interest				Wine Tax			
MSU-Northern (Renew Res Grants & Loans)	0.240	0.240	0.240	DPHHS Alcohol Account (31%)	0.684	0.716	0.749
Renewable Resource Grants & Loans	2.672	2.379	2.589	Tribal Allocations	0.030	0.032	0.033
Reclamation & Development Grants	2.386	1.942	2.187				
Groundwater Assessment	0.300	0.300	0.300	Beer Tax			
Environmental Contingency	0.000	0.175	0.000	DPHHS Alcohol Account (23.26%)	0.885	0.901	0.917
Oil & Gas Damage Mitigation	0.000	0.050	0.000	Tribal Allocations	0.058	0.059	0.061
Water Storage	0.000	0.500	0.000				
Trout Habitat Enhancement	0.350	0.500	0.500	Lodging Facility Use Tax			
Hazardous Waste/CERCLA	0.580	0.328	0.510	DOR Tax Administration	0.141	0.146	0.150
Environmental Quality Protection	0.198	0.114	0.177	State Agency Reimbursements	0.117	0.120	0.124
				Montana Heritage Preservation & Development Acct	0.400	0.400	0.400
Cigarette Tax				Historical Society - Sites & Signs	0.134	0.142	0.152
Long Range Building Fund (4.3%)	1.696	1.633	1.591	University System - Montana Travel Research	0.335	0.355	0.380
DPHHS (VA Hospital) (8.3% or \$2m)	2.000	2.000	2.000	DFWP Parks Maintenance	0.870	0.924	0.987
Tribal (agreement) Allocations	0.851	1.208	1.172	DOC Promotion of Tourism and Movie / TV	9.037	9.596	10.250
				Nonprofit Tourism Corps. (Regional Acc. Tax)	3.012	3.199	3.417
Tobacco Tax							
Tribal (agreement) Allocations	0.084	0.103	0.103				

SCHOOL INTEREST AND INCOME

Revenue Description

When Montana became a state, the United States government granted public lands to the state to provide income to support public schools. This land grant has been supplemented over time through gifts to the state and reversions of unclaimed property. Proceeds from sales of property from the school lands are deposited into a constitutionally-mandated trust fund. Ninety-five percent of the trust fund interest and net income from school lands goes to the guarantee account to be distributed to school districts; the remainder is deposited in the trust fund. Costs of administering state lands are deducted from allocations of the income produced from property sales and leases, and interest income.

Historical and Projected Revenue

Table 1 shows actual revenue from the common school trust for FY 1990 through FY 2004 and forecasts for FY 2005 through FY 2007.

Table 1 School Interest and Income General Fund and Guarantee Account (\$ millions)			
Fiscal Year	General Fund/ Guarantee Account	Percent Change	
A 1994	\$40.944	-1.75%	
A 1995	\$37.904	-7.42%	
A 1996	\$42.032	10.89%	
A 1997	\$39.539	-5.93%	
A 1998	\$41.130	4.02%	
A 1999	\$41.433	0.74%	
A 2000	\$44.296	6.91%	
A 2001	\$46.846	5.76%	
A 2002	\$50.875	8.60%	
A 2003	\$48.977	-3.73%	
A 2004	\$55.663	13.65%	
F 2005	\$58.919	5.85%	
F 2006	\$55.368	-6.03%	
F 2007	\$54.851	-0.93%	

Through FY 2001, school interest and income was deposited in the general fund. SB 495 (2001 session) and HB 7 (2002 special session) created a new special revenue account, the guarantee account. Beginning in FY 2002, school trust

interest and income is deposited in the guarantee account rather than the general fund.

On average, this revenue source grows relatively slowly from year to year. Revenue increased significantly in FY 2002 because SB 495 resulted in a loan of \$46 million from the coal trust to the school trust fund. The higher trust fund balance increased interest earnings.

Revenue from the first 18 million board feet (MMBF) of timber sold during a fiscal year goes for general school funding, and any additional timber sales revenue is earmarked for school technology expenditures. The revenue earmarked for school technology expenditures formerly went in to a separate special revenue account. HB 7 directs that it is to be deposited in the guarantee account and statutorily appropriated for school technology expenditures.

Forecast Methodology and Projection Calculation

There are three parts to forecasting school trust interest and income going to the guarantee account. They are: 1) estimating school trust fund interest earnings; 2) estimating income from state lands; and 3) determining the distribution of the interest and income among the guarantee account, the trust fund, and the costs of administering state lands.

Trust Fund Interest Earnings

There are two steps to estimating the trust fund earnings for any year: estimating the annual yield on the trust fund; and estimating its average balance each year.

The school trust fund is invested in two funds managed by the Board of Investments. On average during FY 2003 and FY 2004, 98.9% was in the Trust Funds Bond Pool and 1.1% was in the Short Term Investment Pool. Other state agencies and trusts also invest in these two funds.

The Trust Fund Bond Pool yield is projected to be 7.16% in FY 2005, 6.23% in FY 2006, and 6.21% in FY 2007. The return on the Short Term Investment Pool is projected to be 2.12% in FY 2005, 3.28% in FY 2005, and 3.68% in FY 2005. These yield forecasts are explained in the introduction to interest earnings.

The annual yield of the common school trust fund is forecast as a weighted average of the yields on the two Board of Investments funds. It equals 98.8% of the yield on the Trust Funds Bond Pool, plus 1.1% of the yield on the Short Term Investment Pool.

The average trust fund balance for each year is calculated in two steps. First, the beginning balance is estimated. For FY 2005, it is known. For FY 2006 and FY

2007, it is calculated by adding the previous year's trust fund deposits to the previous year's beginning balance. Second, deposits during the year are multiplied by the fraction of the year that each is in the trust fund and added to the beginning balance. Tables 4 through 6, located near the end of this revenue estimate, provide the calculations showing how much is deposited annually into the trust fund.

Table 2 shows the forecast of yields, balances, and income earnings. The balance grows each year as part of the interest and income is reinvested in the trust fund. The large increase in FY 2002 is from the loan of \$46.4 million from the coal trust required by SB 495. The school trust is to pay interest on this loan monthly and to repay the principal from mineral royalty receipts beginning in FY 2004. In FY 2004 and FY 2005, 20% of mineral royalties are pledged to repay principal. Beginning in FY 2006, 25% of mineral royalties go to repay the loan.

Table 2 Common School Trust Fund Yield and Earnings (\$ millions)			
Fiscal Year	Annual Yield	Average Balance	Earnings
A 1999	7.648%	\$318.032	\$24.322
A 2000	8.019%	\$323.173	\$25.916
A 2001	8.011%	\$329.649	\$26.407
A 2002	7.760%	\$387.671	\$30.082
A 2003	7.019%	\$387.559	\$27.202
A 2004	7.346%	\$381.041	\$27.991
F 2005	7.082%	\$382.612	\$27.098
F 2006	6.182%	\$385.708	\$23.845
F 2007	6.162%	\$388.736	\$23.955

Income From School Lands

For the purposes of this forecast, the income generating activities on state lands are divided into six categories: agricultural rents; grazing rents; other rents and leases; timber sales; mineral royalties; and miscellaneous receipts. Table 3 shows the actual and forecast income in each of these categories for FY 1998 through FY 2007.

Table 3 Common School Trust Lands Income (\$ millions)									
Fiscal Year	Ag Rents	Grazing Rents	Other Rents	Net Timber Sales	18 MMBF	Over 18 MMBF	Mineral Royalties	Miscellaneous	Total
A 1998	\$8.965	\$3.733	\$2.712	\$2.801	\$2.801		\$5.752	\$1.380	\$28.144
A 1999	\$8.381	\$4.174	\$2.394	\$3.370	\$3.370		\$4.629	\$1.527	\$27.845
A 2000	\$9.053	\$4.066	\$3.294	\$5.380	\$5.380		\$8.541	\$1.309	\$37.022
A 2001	\$8.377	\$4.851	\$9.381	\$1.649	\$1.636	\$0.013	\$11.269	\$1.273	\$38.448
A 2002	\$6.999	\$5.467	\$2.797	\$5.447	\$3.625	\$1.822	\$6.898	\$0.992	\$34.047
A 2003	\$7.975	\$5.243	\$2.604	\$2.803	\$1.703	\$1.100	\$9.703	\$0.578	\$31.710
A 2004	\$8.051	\$4.971	\$3.231	\$4.946	\$3.846	\$1.100	\$12.416	\$0.577	\$39.138
F 2005	\$7.709	\$5.300	\$3.208	\$3.550	\$1.950	\$1.600	\$16.220	\$0.892	\$40.428
F 2006	\$7.438	\$5.308	\$3.274	\$3.647	\$1.947	\$1.700	\$15.392	\$1.234	\$39.939
F 2007	\$7.303	\$5.264	\$3.309	\$3.631	\$1.931	\$1.700	\$14.390	\$1.322	\$38.849

Agricultural rents are received from crops grown on school lands. The state receives a share of the value of the crop, so income from this source varies with crop prices. Agricultural rents are due by December of each year, so the receipts in a fiscal year are for the previous calendar year. The U.S. Department of Agriculture projects that wheat and barley prices will be lower in the next several years, and this is reflected in slightly lower agricultural rents in FY 2005 through FY 2007.

Grazing leases are based on a fixed fee per animal unit month (AUM). Grazing fees are paid in advance and are due by April each year. The fee is recalculated every year, and depends on cattle prices. The fee per AUM in FY 2005 is significantly higher than in FY 2004, and this is reflected in higher forecast grazing revenue. The U.S. Department of Agriculture forecasts cattle prices to be fairly steady for the next several years. Grazing rentals, therefore, are projected to be at about the FY2005 level through FY 2007.

Other rents and leases consist of rental payments on mineral leases and bonuses, and several small sources of income. Mineral rents are payments that leaseholders pay each year to retain the rights to a lease regardless of the level of production. Bonuses are up-front payments for new leases. Total mineral rents and bonuses change from year to year as new mineral leases are signed and old ones expire, but they show no trend.

The Department of Natural Resources and Conservation (DNRC) has an annual timber sales goal based on the estimated maximum sustained yield on state forestlands. The successful bidders on state timber sales have several years to harvest the timber. Timber harvests vary from year to year because timber companies harvest as quickly as they can when prices are high, and wait to harvest when prices are low in the hope that they will go up. In FY 2004, there were large harvests of trees killed or damaged by fire. This resulted in relatively high timber sales revenue with over three-fourths of the revenue going to the school technology fund. DNRC has adopted a new, higher sustainable yield, and this is reflected in projected revenue of about \$3.6 million per year. The school technology portion of timber sales revenue is projected to be \$1.6 million in FY 2005 and \$1.7 million in FY 2006 and FY 2007.

Changes in mineral royalties are primarily due to changes in coal production on school lands and changes in oil and natural gas prices. Most of the state's coal mines have checkerboard mineral rights ownership, where the state owns one or a few sections in a tract where most mineral rights are owned by the federal government or private parties. This causes coal production from state lands to vary from year to year. Estimates of future production on state lands were obtained from the coal companies. Coal royalties are projected to increase in FY 2005 and then decrease in FY 2006 and FY 2007. Oil and gas prices are expected to peak in FY 2005 and then decline. Oil and gas production is projected to increase through FY 2007. Oil and gas royalties are projected to be 45% higher in FY 2005 than in FY

2004 and then to decrease slightly in FY 2006 and FY 2007. Royalties from other minerals are forecast to equal the average of royalties in the last four fiscal years.

Miscellaneous income includes cabin site and commercial leases, special use permits, easements, interest payments on past land sales, and interest earned on school lands income between the time DNRC receives it and the time it is distributed. Miscellaneous income is projected to increase every year through FY 2007. Rising short-term interest rates will increase interest earnings. Income from cabin leases is projected to grow through FY 2007 because of the phase-in of new values following reappraisal. New commercial leases are expected in FY 2005 and FY 2006.

Allocation of Revenue to the Guarantee Account

Part of the revenue from state school land is used to pay the costs of administering state lands. The rest is divided between the guarantee account and the common schools trust fund. There are three allocation formulas applied to different categories of revenues.

Each fiscal year, the legislature makes an appropriation for timber sales costs. This amount is deducted from timber sales revenues. Net revenue from sale of the first 18 MMBF of timber from school land and trust fund interest are allocated 95% to the guarantee account, 4.75% to the trust fund, and 0.25% is earmarked for trust land administration costs. All income from the sale of more than 18 MMBF of timber from school land goes to the guarantee account and is statutorily appropriated for school district technology expenditures.

Rents and miscellaneous revenues that are not specifically earmarked are allocated 3% to the resource development account for expenditures that will increase future income from trust lands, 92.15% to the guarantee account, 4.6075% to the trust fund, and 0.2425% is earmarked for trust land administration costs.

All mineral royalties, income from easements, and timber sales on non-school lands are earmarked first for trust land administration costs. If the total amount earmarked for trust land administration is greater than the amount that the legislature appropriated for this purpose, the excess from school trust lands is deposited in the guarantee account and the excess from other trust lands is deposited in the corresponding trust funds.

All revenues from land sales are deposited in the trust fund.

Table 4 shows the allocation of school trust interest and income for FY 2005.

Table 4 FY 2005 Allocation of School Trust Interest and Income - (\$ millions)									
Income Type	Total	Resource Development		Trust Lands Administration		Guarantee Account		Trust Fund	
		%	\$	%	\$	%	\$	%	\$
Net Timber Sales, 18 MMBF	1.950	0.0%	0.000	0.250%	0.005	95.0%	1.853	4.750%	0.093
Timber over 18 MMBF	1.600	0.0%	0.000	0.0%	0.000	100.0%	1.600	0.000%	0.000
Rents & Misc. Income	18.154	3.0%	0.545	0.2425%	0.044	92.15%	16.729	4.6075%	0.836
Trust Fund Interest	27.098	0.0%	0.000	0.250%	0.068	95.0%	25.743	4.750%	1.287
Mineral Royalties	16.220	0.0%	0.000	100.0%	16.220	0.0%	0.000	0.0%	0.000
Easements	1.077	0.0%	0.000	100.0%	1.077	0.0%	0.000	0.0%	0.000
Land Sales	0.003	0.0%	0.000	0.0%	0.000	0.0%	0.000	100.0%	0.003
Total	66.102		0.545		17.414		45.924		2.219
Initial Trust Lands Administration Allocation									
+ Non-School Revenue Earmarked for Trust Lands Administration					17.414				
= Total Earmarked for Trust Lands Administration					+ 3.008				
					= 20.422				
- Trust Lands Administration Appropriation					- 4.061				
= Excess Earmarked Funds					= 16.361				
x School Share of Trust Lands Administration Excess					x 85.3%				
= Excess Earmarked from School Trust					= 13.951				
% from Royalties, Other						13.951		13.951	
						x 93.1%		x 6.9%	
					17.414	12.995		0.956	
					- 13.951	+ 45.924		+ 2.219	
Final Allocation			0.545		3.463	58.919		3.175	
Interest Payments to Coal Trust						- 3.325			
Principal Payments to Coal Trust						- 2.599			
School Technology Fund Payment						- 1.600			
Funding for School Equalization Aid						= 51.395			

Revenue to the guarantee account is projected to be \$58.919 million in FY 2005. This includes an initial allocation of \$45.924 million and \$12.995 million in mineral royalties not needed to fund trust lands administration. This calculation is shown at the bottom of Table 4. Total school trust revenue earmarked for trust lands administration is \$17.414 million. Revenue of \$3.008 million from other trusts is also earmarked for trust lands administration. Eighty-five percent of the earmarked funds are from school trust revenue. The appropriation for trust lands administration is \$4.061 million. This leaves an excess of \$16.361 million. The 85.3% of this from school trust income is \$13.951 million. This is divided between the guarantee account and the trust fund in the proportions of the earmarked revenue from mineral royalties and other sources. The guarantee account receives 93.1%, or \$12.995 million, which is added to the initial allocation of \$45.924 million to give the total guarantee account revenue of \$58.919 million.

Of the funds deposited in the guarantee account, \$1.600 million is statutorily appropriated for school technology purchases, \$3.325 million is pledged to repay interest on the loan from the coal trust, and \$2.599 million will go to repay principal.

Table 4 also shows the forecast of \$3.175 million to be deposited in the trust fund. This increases the balance in the trust fund at the beginning of FY 2005.

Table 5 shows the allocation of school trust interest and income for FY 2006.

Table 5 FY 2006 Allocation of School Trust Interest and Income - (\$ millions)									
Income Type	Total	Resource Development		Trust Lands Administration		Guarantee Account		Trust Fund	
		%	\$	%	\$	%	\$	%	\$
Net Timber Sales, 18 MMBF	1.947	0.0%	0.000	0.250%	0.005	95.0%	1.850	4.750%	0.092
Timber over 18 MMBF	1.700	0.0%	0.000	0.0%	0.000	100.0%	1.700	0.000%	0.000
Rents & Misc. Income	18.374	3.0%	0.551	0.2425%	0.045	92.15%	16.932	4.6075%	0.847
Trust Fund Interest	23.845	0.0%	0.000	0.250%	0.060	95.0%	22.652	4.750%	1.133
Mineral Royalties	15.392	0.0%	0.000	100.0%	15.392	0.0%	0.000	0.0%	0.000
Easements	1.077	0.0%	0.000	100.0%	1.077	0.0%	0.000	0.0%	0.000
Land Sales	0.003	0.0%	0.000	0.0%	0.000	0.0%	0.000	100.0%	0.003
Total	62.337		0.551		16.578		43.133		2.075
Initial Trust Lands Administration Allocation					16.578				
+ Non-School Revenue Earmarked for Trust Lands Administration					+ 3.023				
= Total Earmarked for Trust Lands Administration					= 19.601				
- Trust Lands Administration Appropriation					- 4.021				
= Excess Earmarked Funds					= 15.580				
x School Share of Trust Lands Administration Excess					x 84.6%				
= Excess Earmarked from School Trust					= 13.177				
% from Royalties, Other						13.177		13.177	
						x 92.8%		x 7.2%	
					16.578	12.235		0.943	
					- 13.177	+ 43.133		+ 2.075	
Final Allocation			0.551		3.400	55.368		3.017	
Interest Payments to Coal Trust						- 2.733			
Principal Payments to Coal Trust						- 3.059			
School Technology Fund Payment						- 1.700			
Funding for School Equalization Aid						= 47.877			

Revenue to the guarantee account is projected to be \$55.368 million in FY 2006. Of the \$55.368 million deposited in the guarantee account, \$1.700 million is statutorily appropriated for school technology purchases, \$2.733 million is pledged to repay interest on the loan from the coal trust, and \$3.059 million will go to repay principal.

Deposits to the school trust fund are projected to be \$3.017 million.

Table 6 shows the allocation of school trust interest and income for FY 2007. Revenue to the guarantee account is projected to be \$54.851 million. Of this, \$1.700 million is for school technology projects, \$2.532 million will go to the coal trust as interest on the loan and \$2.920 million will go to the coal trust to repay principal. The amount deposited in the trust fund is projected to be \$3.039 million.

Table 6 FY 2007 Allocation of School Trust Interest and Income - (\$ millions)									
Income Type	Total	Resource Development		Trust Lands Administration		Guarantee Account		Trust Fund	
		%	\$	%	\$	%	\$	%	\$
Net Timber Sales, 18 MMBF	1.931	0.0%	0.000	0.250%	0.005	95.0%	1.834	4.750%	0.092
Timber over 18 MMBF	1.700	0.0%	0.000	0.0%	0.000	100.0%	1.700	0.000%	0.000
Rents & Misc. Income	18.318	3.0%	0.550	0.2425%	0.044	92.15%	16.880	4.6075%	0.844
Trust Fund Interest	23.955	0.0%	0.000	0.250%	0.060	95.0%	22.757	4.750%	1.138
Mineral Royalties	14.390	0.0%	0.000	100.0%	14.390	0.0%	0.000	0.0%	0.000
Easements	1.077	0.0%	0.000	100.0%	1.077	0.0%	0.000	0.0%	0.000
Land Sales	0.003	0.0%	0.000	0.0%	0.000	0.0%	0.000	100.0%	0.003
Total	61.373		0.550		15.576		43.171		2.076
Initial Trust Lands Administration Allocation					15.576				
+ Non-School Revenue Earmarked for Trust Lands Administration					+ 5.825				
= Total Earmarked for Trust Lands Administration					= 21.401				
- Trust Lands Administration Appropriation					- 4.030				
= Excess Earmarked Funds					= 17.371				
x School Share of Trust Lands Administration Excess					x 72.8%				
= Excess Earmarked from School Trust					= 12.643	12.643		12.643	
% from Royalties, Other						x 92.4%		x 7.6%	
					15.576	11.680		0.963	
					- 12.643	+ 43.171		+ 2.076	
Final Allocation			0.550		2.933	54.851		3.039	
Interest Payments to Coal Trust						- 2.532			
Principal Payments to Coal Trust						- 2.920			
School Technology Fund Payment						- 1.700			
Funding for School Equalization Aid						= 47.699			

Table 7 summarizes the allocation of school trust revenue for FY 2005 to FY 2007.

Table 7 Allocation of School Trust Interest and Income (\$ millions)							
Fiscal Year	Resource Development Account	Trust Lands Administration Account	Coal Trust Loan Principal and Interest	School Technology	School Equalization	Deposited in Trust Fund	Total
F 2005	0.545	3.463	5.924	1.600	51.395	3.175	66.102
F 2006	0.551	3.400	5.792	1.700	47.877	3.017	62.337
F 2007	0.550	2.933	5.452	1.700	47.699	3.039	61.373

STATE LAND TRUSTS INTEREST AND INCOME

Revenue Estimates for FY 2005 through FY 2007

DNRC manages all state trust land. Revenue for the smaller land trusts is estimated as part of the process of estimating revenue from the school trust. Table 8 shows forecast revenue from all state land trusts for FY 2005 through FY 2007 and its allocation.

Table 8
State Trust Funds
Interest and Income Revenue and Its Allocation
(\$ millions)

Trust Fund		Trust Lands Administration	Resource Development Account	Guarantee Account	Special Revenue Fund	Deposited to Trust Fund	Total
FY 2005							
Capitol Building	09007	\$0.321	\$0.009		\$1.577	\$0.000	\$1.907
MSU	09009	\$0.058	\$0.002		\$0.635	\$0.232	\$0.926
Morrill	09010	\$0.097	\$0.005		\$0.395	\$0.389	\$0.885
Deaf & Blind	09011	\$0.021	\$0.002		\$0.282	\$0.084	\$0.389
Pine Hills	09012	\$0.063	\$0.004		\$0.349	\$0.255	\$0.672
Normal School	09013	\$0.028	\$0.004		\$0.562	\$0.111	\$0.705
Montana Tech	09014	\$0.010	\$0.005		\$0.472	\$0.041	\$0.528
Veterans Home	09015	\$0.000	\$0.000		\$0.008	\$0.000	\$0.008
UM	09016	\$0.001	\$0.003		\$0.201	\$0.005	\$0.210
Common Schools	09020	\$3.463	\$0.545	\$58.919		\$3.175	\$66.102
Total FY 2005		\$4.061	\$0.578	\$58.919	\$6.081	\$4.293	\$72.331
FY 2006							
Capitol Building	09007	\$0.338	\$0.009		\$1.591	\$0.000	\$1.938
MSU	09009	\$0.057	\$0.002		\$0.575	\$0.222	\$0.855
Morrill	09010	\$0.090	\$0.005		\$0.389	\$0.349	\$0.833
Deaf & Blind	09011	\$0.019	\$0.002		\$0.261	\$0.072	\$0.354
Pine Hills	09012	\$0.066	\$0.004		\$0.337	\$0.257	\$0.664
Normal School	09013	\$0.032	\$0.004		\$0.513	\$0.126	\$0.676
Montana Tech	09014	\$0.016	\$0.005		\$0.432	\$0.064	\$0.517
Veterans Home	09015	\$0.000	\$0.000		\$0.007	\$0.000	\$0.008
UM	09016	\$0.001	\$0.003		\$0.186	\$0.005	\$0.196
Common Schools	09020	\$3.400	\$0.551	\$55.368		\$3.017	\$62.337
Total FY 2006		\$4.021	\$0.585	\$55.368	\$5.993	\$4.112	\$68.377
FY 2007							
Capitol Building	09007	\$0.851	\$0.009		\$3.947	\$0.000	\$4.807
MSU	09009	\$0.045	\$0.002		\$0.587	\$0.193	\$0.826
Morrill	09010	\$0.078	\$0.005		\$0.409	\$0.338	\$0.830
Deaf & Blind	09011	\$0.014	\$0.002		\$0.264	\$0.059	\$0.339
Pine Hills	09012	\$0.061	\$0.004		\$0.352	\$0.262	\$0.679
Normal School	09013	\$0.033	\$0.004		\$0.519	\$0.140	\$0.696
Montana Tech	09014	\$0.014	\$0.005		\$0.434	\$0.062	\$0.515
Veterans Home	09015	\$0.000	\$0.000		\$0.007	\$0.000	\$0.008
UM	09016	\$0.002	\$0.003		\$0.185	\$0.007	\$0.197
Common Schools	09020	\$2.933	\$0.550	\$54.851		\$3.039	\$61.373
Total FY 2007		\$4.030	\$0.583	\$54.851	\$8.406	\$4.101	\$70.270

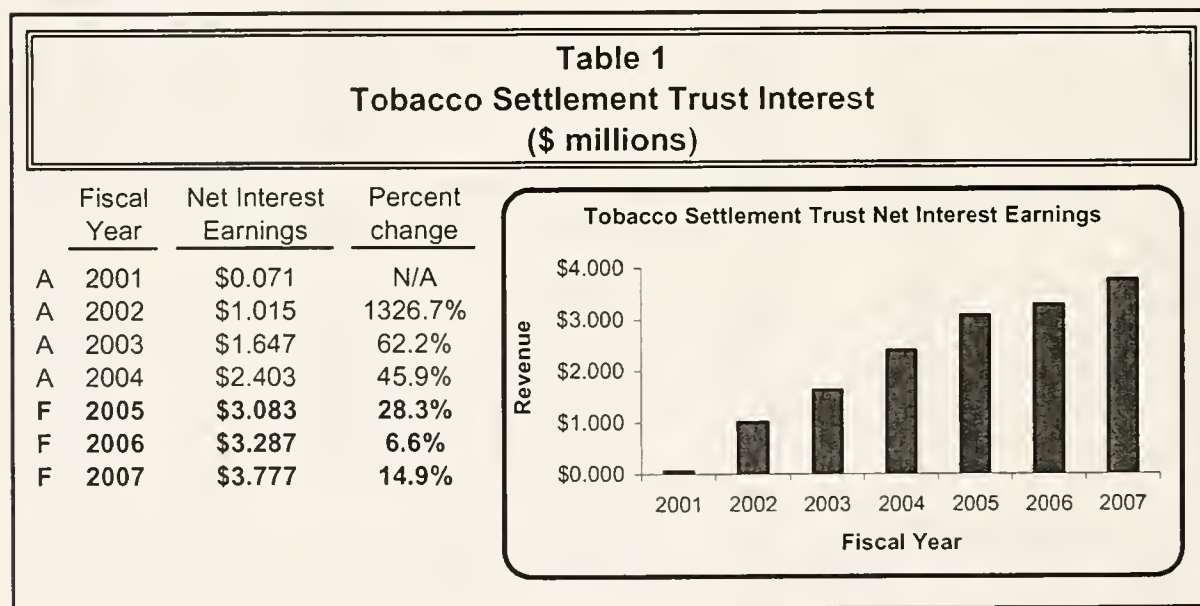
TOBACCO SETTLEMENT TRUST INTEREST

Revenue Description

Montana receives payments from a multi-state settlement with tobacco companies. Forty percent of the receipts from this settlement are deposited in the tobacco settlement trust. Ten percent of interest from the trust fund is retained in the trust and ninety percent is deposited in a special revenue account and may be appropriated for tobacco prevention and health care programs.

Historical and Projected Yields

The tobacco settlement trust was established in January 2001 following passage of Constitutional Amendment 35 in the November 2000 election. Table 1 shows actual net interest earnings for FY 2001 through FY 2004 and projections for FY 2005 through FY 2007.



Interest earnings are growing rapidly because annual deposits to the trust fund are significant relative to the trust fund balance. In FY 2004, the beginning balance was \$35.8 million, and deposits were \$10.7 million, or 30% of the beginning balance.

Forecast Methodology and Projection Calculation

The trust fund balance is invested in two mutual funds managed by the Board of Investments, the Trust Fund Bond Pool (TFBP) and the Short Term Investment Pool

(STIP). On average 97.6% of the trust fund balance is in TFBP and 2.4% is in STIP. The annual yield of the trust fund is forecast as a weighted average of the forecast TFBP and STIP yields, weighted by the percentage of the trust fund in each. Table 2 shows projected yields for TFBP, STIP, and the tobacco trust for FY 2004 through FY 2007.

Table 2 Tobacco Settlement Trust Fund Yield			
Fiscal Year	TFBP Yield	STIP Yield	Trust Fund Yield
F 2005	7.16%	2.12%	7.04%
F 2006	6.23%	3.28%	6.16%
F 2007	6.21%	3.68%	6.15%

The trust fund earns interest monthly. Ten percent of the interest is retained in the trust and added to the balance. Because the balance changes every month, projected interest earnings are calculated for each month and then summed to give annual interest earnings. Almost all of the tobacco settlement payment is received in April. Thus, the May and June balances are significantly higher than the previous months. Table 3 shows the interest calculation for two months in FY 2005.

Table 3 Example - Monthly Interest Calculations			
	<div>April 2005</div> <div>May 2005</div>		
Beginning Balance	\$47,003,409	\$57,604,981	
x	0.59%	x	0.59%
Gross Interest	\$275,716	\$337,903	
Gross Interest	\$275,716	\$337,903	
x	0.1	x	0.1
Retained Interest	\$27,572	\$33,790	
Gross Interest	\$275,716	\$337,903	
x	0.9	x	0.9
Net Interest	\$248,144	\$304,113	
Beginning Balance	+ \$47,003,409	+ \$57,604,981	
Retained Interest	+ \$27,572	+ \$33,790	
Settlement Payments	+ \$10,574,000	+ \$0	
Ending Balance	\$57,604,981	\$57,638,771	

The middle column shows the calculations for April. The balance at the beginning of April is \$47.003 million. Interest of \$275,716 for the month is calculated by multiplying the balance by one-twelfth of the interest rate ($0.59\% = 7.16\%/12$). Ten percent of the interest, \$27,572, is retained in the trust and ninety percent, \$248,144 is deposited in the state special revenue account. The ending balance of \$57.605 million is the sum of the beginning balance, the retained interest, and tobacco settlement payments during the month. The right-hand column shows the same calculations for May.

Table 4 summarizes the results of the monthly balance calculations. It shows the actual balance at the beginning of FY 2005 and projected beginning balances for FY 2006 and FY 2007. It also shows projections of tobacco settlement payments, the sum of the twelve months of retained interest, and the resulting average annual balance for each fiscal year.

Table 4 Trust Fund Balances and Deposits (\$ millions)				
Fiscal Year	Beginning Balance	Settlement Payment	Retained Interest	Average Balance
F 2005	\$46.756	\$10.574	\$0.343	\$48.670
F 2006	\$57.673	\$8.612	\$0.365	\$59.271
F 2007	\$66.650	\$8.505	\$0.420	\$68.256

Table 5 summarizes the results of the monthly interest calculations. Multiplying the average annual balance by the annual yield gives the sum of the twelve monthly interest earnings. Ten percent of the interest earnings are retained in the trust and ninety percent are deposited in the special revenue account.

Table 5 Trust Fund Interest Summary (\$ millions)					
Fiscal Year	Average Balance	Yield	Gross Interest	Retained in Trust	Net Interest
F 2005	\$48.670	7.04%	\$3.426	\$0.343	\$3.083
F 2006	\$59.271	6.16%	\$3.652	\$0.365	\$3.287
F 2007	\$68.256	6.15%	\$4.196	\$0.420	\$3.777

TREASURE STATE ENDOWMENT FUND INTEREST

Revenue Description

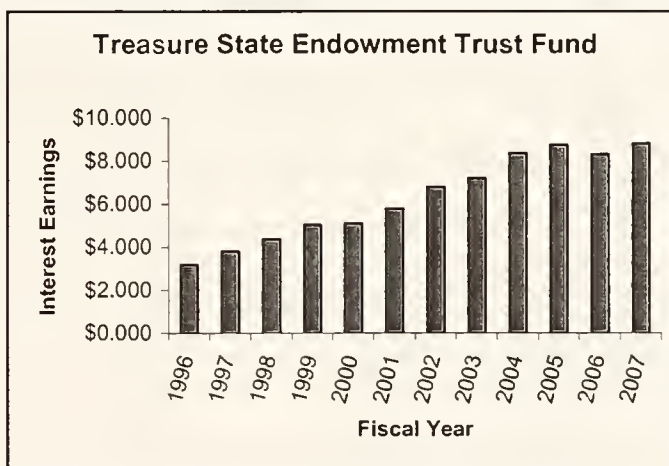
Article IX, Section 5 of the Montana Constitution established a permanent trust fund into which at least half of coal severance tax revenue must be deposited. The trust fund is divided into several funds with different purposes. Income from the Treasure State Endowment Fund is used for local government infrastructure investments.

Projected Revenue

Table 1 shows actual interest earnings for the treasure state endowment fund from FY 1996 through FY 2004 and projections for FY 2005 through FY 2007.

Table 1
Treasure State Endowment Trust Fund Interest Earnings
(\$ millions)

<u>Fiscal Year</u>	<u>Interest Earnings</u>	<u>Percent Change</u>
A 1996	\$3.194	NA
A 1997	\$3.824	19.73%
A 1998	\$4.374	14.38%
A 1999	\$5.031	15.01%
A 2000	\$5.106	1.49%
A 2001	\$5.803	13.64%
A 2002	\$6.814	17.42%
A 2003	\$7.201	5.68%
A 2004	\$8.371	16.26%
F 2005	\$8.765	4.70%
F 2006	\$8.322	-5.05%
F 2007	\$8.812	5.88%



Earnings grew from FY 1997 through FY 2004, generally through increasing balances due to contributions from the coal tax. Income in FY 2005 is projected to be higher due to expected capital gains distributions. Decreasing yields due to the replacement of older, high coupon bonds with newer low coupon bonds is expected to dampen interest earnings growth from FY 2005 through FY 2007.

Forecast Methodology and Projection Calculation

There are five steps to forecasting revenue from the trust fund. First, the average monthly balance of the fund must be projected. Second, this balance is allocated to the three basic types of investment made by the fund. Third, monthly yields are projected for each type of investment. Fourth, the three balances are multiplied by their respective yields to find monthly interest income. Finally, the twelve months of income are summed to estimate annual interest income. This write-up shows annual totals for each of the steps.

Treasure State Endowment Trust Fund Balance

Half of coal severance tax receipts are deposited in the coal tax trust funds. Beginning in FY 2004, 12.5% of collections are to be deposited in the permanent fund, 25% in the treasure state endowment trust fund, and 12.5% in the treasure state endowment regional water system trust fund (17-5-703, MCA).

Table 2 shows actual coal severance tax receipts and deposits to the components of the coal tax trust fund for FY 2003 and FY 2004 and projections for FY 2005 through FY 2007. In FY 2003 transfers normally distributed to the permanent fund were distributed to the treasure state endowment instead.

Table 2				
Coal Severance Tax Revenue and Trust Fund Deposits				
(\$ millions)				
Fiscal Year	Severance Tax	Permanent Fund	Treasure State Endowment	Regional Water System Fund
A 2003	\$31.789	\$0.000	\$10.702	\$3.567
A 2004	\$31.371	\$3.336	\$6.672	\$3.336
F 2005	\$35.920	\$4.490	\$8.980	\$4.490
F 2006	\$31.986	\$3.998	\$7.996	\$3.998
F 2007	\$30.865	\$3.858	\$7.716	\$3.858

Each biennium, the legislature approves a list of projects for funding from the income of the treasure state endowment fund. If trust fund earnings exceed the amount appropriated for infrastructure projects, the difference is added to the trust fund balance.

Coal severance tax is collected quarterly, and the average balance of one of the trusts during a fiscal year equals the beginning balance plus the quarterly deposits, each multiplied by the fraction of the year remaining when the deposit is made. If the deposits are of equal size, the increase in the average balance is $\frac{3}{8}$ of the sum of the deposits ($\frac{3}{8} = \frac{1}{4} \times \frac{3}{4} + \frac{1}{4} \times \frac{1}{2} + \frac{1}{4} \times \frac{1}{4} + \frac{1}{4} \times 0$).

Table 3 shows actual treasure state endowment fund average annual balances for FY 1998 through FY 2004 and projections for FY 2005 through FY 2007.

Annual Trust Fund Yields

The Montana Board of Investments manages the treasure state endowment trust fund. The Board of Investments invests trust fund balances in two mutual funds that it manages, the Trust Funds Bond Pool (TFBP) and the Short Term Investment Pool (STIP). The forecasts of the annual yields of these mutual funds are explained in the Interest Earnings Introduction. The Board of Investments also makes loans, primarily to local governments for infrastructure projects, from the treasure state endowment fund. The average yield on these loans from October 2003 through September 2004 was 7.12%. The forecast assumes that this will be unchanged through FY 2007.

On average from October 2003 through September 2004, the treasure state endowment fund has been invested 85.71% in TFBP, 12.42% in fixed rate loans, and 1.87% in STIP. The forecast assumes that these percentages will continue to hold through FY 2007.

Treasure State Endowment Trust Fund Interest Earnings

Table 4 shows the annual average balance, interest earnings, and derived annual yield for FY 2004 through FY 2007. Forecast yield is higher in FY 2005 largely because of substantial expected capital gains in the Trust Fund Bond Pool. Yield is expected to decline in FY 2006 and FY 2007 due to a decreasing average coupon rate in the same pool. Thus earnings are expected to decrease in FY 2006 despite the increasing average balance; however, with the increase in the average balance, interest earnings grow in FY 2007.

Table 3 Average Balances (\$ millions)	
--- Treasure State Endowment ---	
Fiscal Year	Average Balance
A 1998	\$52.083
A 1999	\$60.685
A 2000	\$68.591
A 2001	\$82.005
A 2002	\$93.772
A 2003	\$105.082
A 2004	\$115.427
F 2005	\$123.056
F 2006	\$131.555
F 2007	\$139.325

Table 4 Treasure State Endowment Fund Projected Interest Earnings			
--- Treasure State Endowment Fund ---			
Fiscal Year	Average Balance (\$ millions)	Interest Earnings (\$ millions)	Derived Annual % Yield
A 2004	\$115.427	\$8.091	7.01%
F 2005	\$123.056	\$8.765	7.12%
F 2006	\$131.555	\$8.322	6.33%
F 2007	\$139.325	\$8.812	6.32%

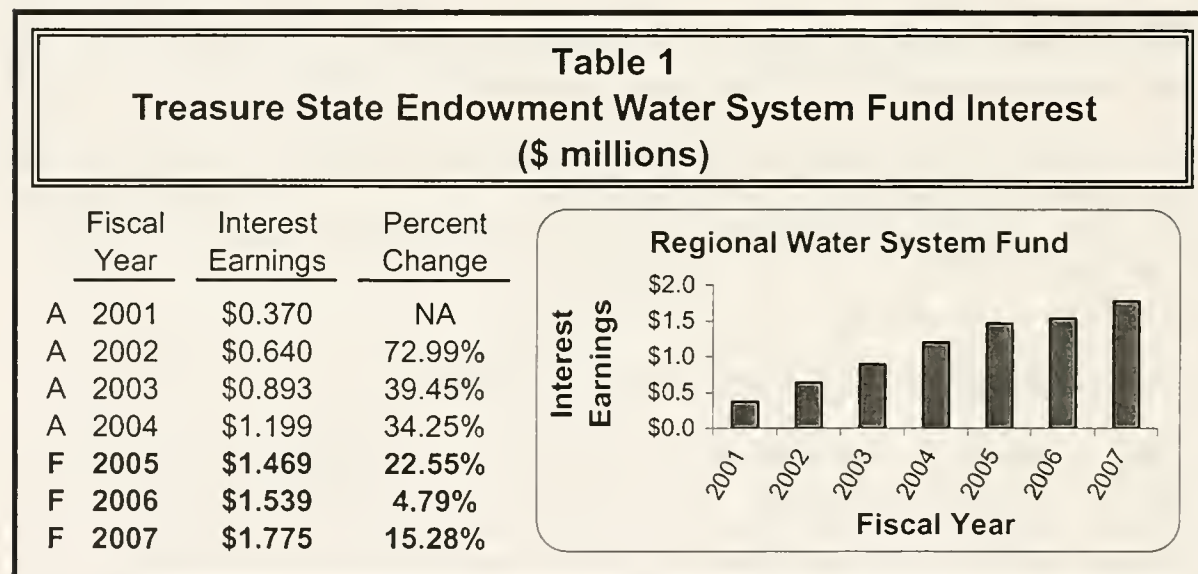
TREASURE STATE ENDOWMENT REGIONAL WATER SYSTEM TRUST FUND INTEREST

Revenue Description

Article IX, Section 5 of the Montana Constitution established a permanent trust fund into which at least half of coal severance tax revenue must be deposited. The trust fund is divided into several funds with different purposes. Income from the treasure state endowment regional water system trust fund is to be used for regional water systems.

Projected Revenue

Table 1 shows actual interest earnings for the treasure state endowment regional water system trust fund from FY 2001 through FY 2004 and projections for FY 2005 through FY 2007.



Earnings grew from FY 2001 through FY 2004, generally through increasing balances due to contributions from the coal tax. Income in FY 2005 is projected to be higher due to expected capital gains distributions. Decreasing yields due to the replacement of older, high coupon bonds with newer low coupon bonds is expected to dampen interest earnings growth from FY 2005 through FY 2007. Interest earnings are projected to increase through FY 2007 due to the projected rise in the average fund balance.

Forecast Methodology and Projection Calculation

There are five steps to forecasting revenue from the trust fund. First, the average monthly balance of the fund must be projected. Second, this balance is allocated to the two basic types of investment made by the fund. Third, monthly yields are projected for each type of investment. Fourth, the balances for each investment type are multiplied by their respective yields to find monthly interest income. Finally, the twelve months of income are summed to estimate annual interest income. This write-up shows annual totals for each of the steps.

Treasure State Endowment Regional Water System Trust Fund Balance

Half of coal severance tax receipts are deposited in the coal tax trust funds. Beginning in FY 2004, 12.5% of collections are to be deposited in the permanent fund, 25% in the treasure state endowment trust fund, and 12.5% in the treasure state endowment regional water system trust fund (17-5-703, MCA).

Table 2 shows actual coal severance tax receipts and deposits to the components of the coal tax trust fund for FY 2003 and FY 2004 and projections for FY 2005 through FY 2007.

Table 2 Coal Severance Tax Revenue and Trust Fund Deposits (\$ millions)				
Fiscal Year	Severance Tax	Permanent Fund	Treasure State Endowment	Regional Water System Fund
A 2003	\$31.789	\$0.000	\$10.702	\$3.567
A 2004	\$31.371	\$3.336	\$6.672	\$3.336
F 2005	\$35.920	\$4.490	\$8.980	\$4.490
F 2006	\$31.986	\$3.998	\$7.996	\$3.998
F 2007	\$30.865	\$3.858	\$7.716	\$3.858

Coal severance tax is collected quarterly, and the average balance of one of the trusts during a fiscal year equals the beginning balance plus the quarterly deposits, each multiplied by the fraction of the year remaining when the deposit is made. If the deposits are of equal size, the increase in the average balance is 3/8 of the sum of the deposits ($3/8 = 1/4 \times 3/4 + 1/4 \times 1/2 + 1/4 \times 1/4 + 1/4 \times 0$).

Table 3 shows actual treasure state endowment regional water system trust fund average balances for FY 2001 through FY 2004 and projections for FY 2005 through FY 2007.

Annual Trust Fund Yields

The Montana Board of Investments manages the treasure state regional water system fund. The Board of Investments invests trust fund balances in two mutual funds that it manages, the Trust Funds Bond Pool (TFBP) and the Short Term Investment Pool (STIP). The forecasts of the annual yields of these mutual funds are explained in the Interest Earnings Introduction. Payouts on TFPB and STIP are made from the Board of Investments proportional to end-of-month balances in those accounts.

On average from October 2003 through September 2004, the Treasure State Endowment Regional Water System trust fund has been invested 97.91% in TFBP and 2.09% in STIP. The forecast assumes that these percentages will continue to hold through FY 2007.

Treasure State Endowment Regional Water Trust Fund Interest

Table 4 shows the annual average balance, interest earnings, and derived annual yield for FY 2004 through FY 2007. Forecast yield is higher in FY 2005 largely because of substantial expected capital gains in the Trust Fund Bond Pool. Annual yield is expected to decline in FY 2006 and FY 2007 due to decreasing average coupon rates in the same pool. Projected increases in earnings through FY 2007 are driven primarily by projected increases in the average balance.

Table 3
Regional Water System
Fund Balance
(\$ millions)

---Regional Water System---	
Fiscal Year	Average Balance
A 2001	\$5.130
A 2002	\$9.033
A 2003	\$12.806
A 2004	\$16.810
F 2005	\$20.696
F 2006	\$24.946
F 2007	\$28.830

Table 4
Regional Water System Fund
Projected Interest Earnings

---Regional Water System Fund---				
Fiscal Year	Average Balance (\$ millions)		Interest Earnings (\$ millions)	Derived Annual % Yield
A 2004	\$16.810	x	\$1.178	= 7.01%
F 2005	\$20.696	x	\$1.469	= 7.10%
F 2006	\$24.946	x	\$1.539	= 6.17%
F 2007	\$28.830	x	\$1.775	= 6.16%

RESOURCE INDEMNITY TAX

Revenue Description

Chapter 38 of Title 15, MCA, created a resource indemnity and groundwater assessment tax. The tax (also called simply the resource indemnity tax or RIT) funds a resource indemnity trust and provides revenues for groundwater assessment and a variety of development programs to benefit the state and its citizens. The purpose of the trust and other programs is to indemnify the citizens of Montana for depletion of the state's resource base and for environmental damage from mineral development.

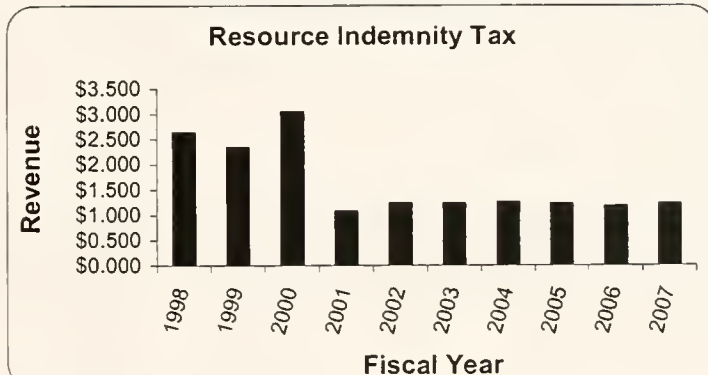
When the trust fund balance was less than \$100 million, 50% of the resource indemnity and groundwater assessment tax was deposited in the trust fund. The balance reached \$100 million in December 2002. Deposits ceased at that point, and the balance has remained at \$100 million.

Historical and Projected Revenue

Table 1 shows actual revenues for FY 1998 through FY 2004 and projected revenues for FY 2005 through FY 2007. The revenue varies due to fluctuations in price and production for the ores.

Table 1
Resource Indemnity Tax
(\$ millions)

	<u>Fiscal Year</u>	<u>Tax Revenue</u>	<u>Percent Change</u>
A	1998	\$2.632	
A	1999	\$2.335	-11.28%
A	2000	\$3.043	30.32%
A	2001	\$1.077	-64.60%
A	2002	\$1.224	13.67%
A	2003	\$1.226	0.11%
A	2004	\$1.251	2.03%
F	2005	\$1.222	-2.29%
F	2006	\$1.167	-4.53%
F	2007	\$1.217	4.29%



Forecast Methodology and Projection Calculation

The resource indemnity and groundwater assessment tax is levied on the value of mineral production each calendar year. Payment for the previous calendar year is due by the end of March. About 90% of tax receipts are from coal, oil, and natural gas production. Producers of talc, limestone, sand and gravel, vermiculite, gems, and other non-metalliferous minerals pay most of the remainder. Metal mines pay the resource indemnity tax only if they are too small to pay the metalliferous mines tax.

Tax receipts from coal, oil, and natural gas production were estimated by applying the appropriate tax rates to the production estimates used for the coal severance tax and the oil and natural gas tax revenue forecasts. Other mineral production revenue is the average of FY 2001 through FY 2004 revenue. Table 2 shows resource indemnity tax receipts for FY 2001 through FY 2004 and forecasts of receipts for FY 2005 through FY 2007.

Table 2
Resource Indemnity Tax
(\$ millions)

Fiscal Year	Coal	Other Minerals	Total
A 2001	\$0.952	\$0.125	\$1.077
A 2002	\$0.999	\$0.225	\$1.224
A 2003	\$0.963	\$0.262	\$1.226
A 2004	\$1.088	\$0.162	\$1.251
F 2005	\$1.028	\$0.194	\$1.222
F 2006	\$0.973	\$0.194	\$1.167
F 2007	\$1.023	\$0.194	\$1.217

Allocation of Resource Indemnity Tax Revenue

Table 3 shows the allocation of the resource indemnity tax revenue.

Table 3
Resource Indemnity Tax Allocation
(\$ millions)

Fiscal Year	Resource Indemnity Trust	CERCLA match debt service fund	Groundwater Assessment Account	Reclamation and Development Grants Account	Natural Resource Workers' Tuition Scholarship Account	Orphan Share Account	Total
A 2001	\$0.538	\$0.000	\$0.300	\$0.119	\$0.000	\$0.119	\$1.077
A 2002	\$0.612	\$0.000	\$0.300	\$0.156	\$0.000	\$0.156	\$1.224
A 2003	\$0.000	\$0.000	\$0.366	\$0.430	\$0.150	\$0.280	\$1.226
A 2004	\$0.000	\$0.000	\$0.366	\$0.442	\$0.150	\$0.442	\$1.251
F 2005	\$0.000	\$0.000	\$0.366	\$0.428	\$0.150	\$0.278	\$1.222
F 2006	\$0.000	\$0.160	\$0.366	\$0.320	\$0.150	\$0.170	\$1.167
F 2007	\$0.000	\$0.320	\$0.366	\$0.265	N/A	\$0.265	\$1.217

RESOURCE INDEMNITY TRUST INTEREST

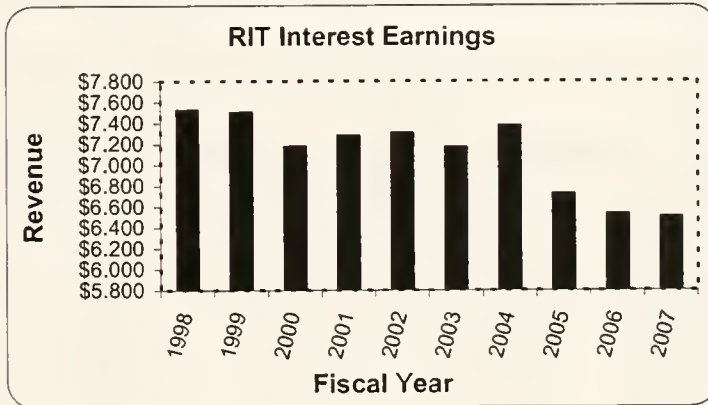
Revenue Description

Chapter 38 of Title 15, MCA, created a resource indemnity trust fund to indemnify the citizens of Montana for depletion of the state's resource base and for environmental damage from mineral development. The trust fund balance reached \$100 million in December 2002. Deposits ceased at that point, and the balance has remained at \$100 million. Income from the trust fund is used to fund a variety of environmental and natural resource programs.

Historical and Projected Revenue

Table 1 shows actual interest earning for FY 2001 through FY 2004 and projected interest earnings for FY 2005 through FY 2007.

Table 1 Resource Indemnity Trust Interest Earnings (\$ millions)		
<u>Fiscal Year</u>	<u>Interest Earnings</u>	<u>Percent Change</u>
A 1998	\$7.527	
A 1999	\$7.505	-0.67%
A 2000	\$7.177	-4.67%
A 2001	\$7.282	1.14%
A 2002	\$7.307	0.35%
A 2003	\$7.168	-1.91%
A 2004	\$7.375	2.90%
F 2005	\$6.726	-8.80%
F 2006	\$6.528	-2.95%
F 2007	\$6.502	-0.40%



The variation from year to year reflects growth in the trust fund balance through December 2002 and fluctuating interest rates. Yield on the trust fund ranged from a high of \$7.527 million in FY 1998 to a low of \$7.168 million in FY 2003.

Forecast Methodology and Projection Calculation

There are three steps to forecasting interest revenue from the resource indemnity trust fund. First, the balance of the trust fund must be projected. Second, the interest to be earned on that balance is projected. Third, the interest income is allocated to the various accounts that receive a share.

Trust Fund Balances

Trust fund balances are held in the Short Term Investment Pool (STIP) and the Trust Funds Bond Pool (TFBP). The Montana Board of Investments manages the pools. The balances held in STIP are invested in the money market; the balances held in TFBP are generally invested in long-term commercial bonds and mortgage backed securities. The Short Term Investment Pool offers greater liquidity but a lower expected return than the Trust Funds Bond Pool.

Interest income for the resource indemnity trust fund is the sum of the interest income from the STIP balances and the TFBP balances. Interest income from the STIP balances is paid on the actual value of funds invested in the pool. Interest income from the TFBP balances is paid on the par value of funds invested in the bond pool. The Trust Funds Bond Pool is a mutual fund with a par value of \$100 per share. This was the initial buy-in value of the pool at its inception on October 1, 1995. The current price of a share in the pool will vary depending upon the underlying value of the pool. If the price of a share is \$98, the par value of a \$1,000 investment is $\$1,000/0.98 = \1020.41 . The income of the bond pool is distributed on a par value basis, with each investor receiving distributions in proportion to the par value of their investment in the pool.

Table 2 shows STIP, TFBP, and total actual balances from FY 2001 through FY 2004 and forecast balances for FY 2005 through FY 2007.

Table 2			
Resource Indemnity Trust Balance			
(\$ millions)			
Fiscal Year	STIP Balance	TFBP Balance	Total Balance
A 2001	\$0.938	\$97.630	\$98.568
A 2002	\$0.827	\$99.837	\$100.663
A 2003	\$0.258	\$100.000	\$100.258
A 2004	\$0.001	\$100.000	\$100.001
F 2005	\$0.001	\$100.000	\$100.001
F 2006	\$0.001	\$100.000	\$100.001
F 2007	\$0.001	\$100.000	\$100.001

In August of FY 2005, the proportion of the total balance held in STIP was about 0.0024%. The contribution of STIP income to total income in the resource indemnity trust fund is negligible. The proportion held in STIP is very small because of very low returns in the money market. This trend is expected to continue through FY 2007. Thus the projected balance held in the STIP is projected to remain very small.

Table 3 below shows the actual and estimated yield and income for the different balances from FY 2001 to FY 2007.

Table 3 Investment Pool Balances, Yields and Income (\$ millions)								
FY	STIP Balance	STIP Yield	STIP Income	TFBP Balance	TFBP Par Balance	TFBP Yield	TFBP Income	Total Income
A 2001	\$0.938	8.10%	\$0.076	\$97.630	\$102.318	7.04%	\$7.206	\$7.282
A 2002	\$0.827	2.56%	\$0.021	\$99.837	\$104.572	6.97%	\$7.286	\$7.307
A 2003	\$0.258	2.48%	\$0.006	\$100.000	\$104.735	6.84%	\$7.161	\$7.168
A 2004	\$0.001	1.11%	\$0.000	\$100.000	\$104.735	7.04%	\$7.375	\$7.375
F 2005	\$0.001	1.93%	\$0.000	\$100.000	\$104.735	6.42%	\$6.726	\$6.726
F 2006	\$0.001	3.28%	\$0.000	\$100.000	\$104.735	6.23%	\$6.528	\$6.528
F 2007	\$0.001	3.68%	\$0.000	\$100.000	\$104.735	6.21%	\$6.502	\$6.502

Allocation of Resource Indemnity Trust Fund Income

Table 4 shows the allocation of interest income on the Resource Indemnity Trust Fund for FY 2003 through FY 2007.

Table 4 Resource Indemnity Trust Interest Allocation (\$ millions)					
Account or Program	FY2003	FY2004	FY2005	FY2006	FY2007
MSU-Northern	\$0.240	\$0.240	\$0.240	\$0.240	\$0.240
Renewable Resource Grants & Loans	\$2.785	\$2.653	\$2.672	\$2.379	\$2.589
Reclamation & Development Grants	\$2.585	\$2.352	\$2.386	\$1.942	\$2.187
Groundwater Assessment	\$0.300	\$0.300	\$0.300	\$0.300	\$0.300
Environmental Contingency	\$0.000	\$0.175	\$0.000	\$0.175	\$0.000
Oil & Gas Damage Mitigation	\$0.000	\$0.050	\$0.000	\$0.050	\$0.000
Water Storage	\$0.000	\$0.500	\$0.000	\$0.500	\$0.000
Trout Habitat Enhancement	\$0.350	\$0.350	\$0.350	\$0.500	\$0.500
Hazardous Waste/CERCLA	\$0.677	\$0.563	\$0.580	\$0.328	\$0.510
Environmental Quality Protection	\$0.231	\$0.192	\$0.198	\$0.114	\$0.177
Total RIT Interest Earnings	\$7.168	\$7.375	\$6.726	\$6.528	\$6.502

At the beginning of each biennium, \$175,000 is allocated to the environmental contingency account created by 75-1-1011, MCA; \$50,000 is allocated to the oil and gas production damage mitigation account created by 82-11-161, MCA; and \$500,000 is allocated to the water storage account created by 85-1-631, MCA.

At the beginning of each fiscal year, \$240,000 is allocated to the environmental science and water quality program at MSU-Northern; \$2 million is allocated to the

renewable resource grant and loan program created by 85-1-604, MCA for grants; \$1.5 million is allocated to the reclamation and development grant program created by 90-2-1104, MCA; and \$300,000 is allocated to the groundwater assessment account created by 85-2-905, MCA. Beginning in FY 2002, \$500,000 is allocated each fiscal year to the Department of Fish, Wildlife and Parks for the trout habitat enhancement program created by 87-1-283, MCA, with revenue reductions occurring in the 2003 and 2005 biennia due to special session actions.

Remaining funds are allocated 30% to the renewable resource grant and loan program; 26% to the hazardous waste/CERCLA account created by 75-10-621, MCA; 35% to the reclamation and development grant program; and 9% to the environmental quality protection fund created by 75-10-704, MCA.

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